# MODERN BUSINESS

ALEXANDER HAMILTON INSTITUTE

Stephenson

EX LIBRIS

GILBERT THOMAS STEPHENSON

DR. NORMAN A. WIGGINS

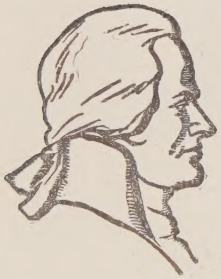
Gilbert & Stephenson

Digitized by the Internet Archive
in 2026

https://archive.org/details/organizationcont0000char

# Modern Business

A SERIES OF TEXTS PREPARED AS PART OF THE MODERN BUSINESS COURSE AND SERVICE OF THE ALEXANDER HAMILTON INSTITUTE



ALEXANDER HAMILTON INSTITUTE
NEW YORK

# Modern Business

EDITOR-IN-CHIEF

JOSEPH FRENCH JOHNSON

Dean, New York University School of Commerce, Accounts and Finance

MANAGING EDITOR

ROLAND P. FALKNER

ASSOCIATE EDITORS

LEO GREENDLINGER, CHARLES W. HURD

---


| *Volume* | *Titles* | *Authors* |
|---|---|---|
| 1. | BUSINESS AND THE MAN | Joseph French Johnson |
| 2. | ECONOMICS OF BUSINESS | The Editors |
| 3. | ORGANIZATION AND CONTROL | Charles W. Gerstenberg |
| 4. | PLANT MANAGEMENT | Dexter S. Kimball |
| 5. | MARKETING AND MERCHANDISING | The Editors |
| 6. | ADVERTISING PRINCIPLES | Herbert F. de Bower |
| 7. | SALESMANSHIP AND SALES MANAGEMENT | John G. Jones |
| 8. | CREDIT AND THE CREDIT MAN | The Editors |
| 9. | ACCOUNTING PRINCIPLES | The Editors |
| 10. | COST FINDING | Dexter S. Kimball |
| 11. | CORPORATION FINANCE | William H. Walker |
| 12. | BUSINESS CORRESPONDENCE | Harrison McJohnston |
| 13. | ADVERTISING CAMPAIGNS | Mac Martin |
| 14. | RAILWAY TRAFFIC | Edwin J. Clapp |
| 15. | FOREIGN TRADE AND SHIPPING | J. Anton de Haas |
| 16. | BANKING | Major B. Foster |
| 17. | DOMESTIC AND FOREIGN EXCHANGE | E. L. Stewart Patterson |
| 18. | INSURANCE | The Editors |
| 19. | OFFICE MANAGEMENT | The Editors |
| 20. | THE EXCHANGES AND SPECULATION | Albert W. Atwood |
| 21. | ACCOUNTING PRACTICE AND AUDITING | John T. Madden |
| 22. | FINANCIAL AND BUSINESS STATEMENTS | Leo Greendlinger |
| 23. | INVESTMENT | Edward D. Jones |
| 24. | BUSINESS AND THE GOVERNMENT | Jeremiah W. Jenks |

# ORGANIZATION AND CONTROL

BY

CHARLES W. GERSTENBERG, J.D.

*Professor of Finance, and Head of the Department of Finance, New York University School of Commerce, Accounts and Finance*

WITH THE COLLABORATION OF

WALTER S. JOHNSON, B.A., B.C.L.

*Member of the Bar of the Province of Quebec, Lecturer on Railway Law, and Sessional Lecturer on Constitutional Law, McGill University*

*MODERN BUSINESS*

VOLUME 3

DR. NORMAN A. WIGGINS

ALEXANDER HAMILTON INSTITUTE
NEW YORK

COPYRIGHT, 1918, 1919, BY
ALEXANDER HAMILTON INSTITUTE

COPYRIGHT IN GREAT BRITAIN, 1918, 1919, BY
ALEXANDER HAMILTON INSTITUTE

The title and contents of this volume as well as the business growing out of it, are further protected by laws relating to trade marks and unfair trade. All rights reserved, including translation into Scandinavian.

*Registered trade mark, Reg. U. S. Pat. Off., Marca Registrada, M. de F.*

MADE IN U. S. A.

# PREFACE

Perhaps no step in the prosecution of a business is so important to the individual as the organization of the ownership. While the application of correct principles of production, marketing, financing and accounting are necessary to insure success, they determine the amount of profits the business as a whole is to have. But every man goes into a business for income and the amount of his own income will depend not only on the amount of the profits of the whole business but on his own proportionate share of those profits. The division of the profits into shares depends almost entirely on the form of organization.

Moreover, when men enter business they hazard not only their time and a definite amount of wealth in the enterprise, but perhaps other wealth that was intended to be kept separate. Indeed, embarking on a business venture may be but the beginning of the loss of the income of future years when all chance of profits has ceased and the business represents nothing but a lot of debts that remain to be liquidated. Risk is an important element that is varied by the form of organization selected.

It is true that the form of organization need never be final. But the trouble of making changes as well as the expense frequently acts as a sufficient deterrent



000344

to prevent advantageous changes. Moreover, the original form of organization will determine the division among the owners of the right to control the business and this right of control determines whether the form of organization is to be changed or left as it is.

The purpose of this book then is to describe the various forms of business organization recognized and used among English speaking people and to show how these forms affect the income, risk and right to control of the individual owner.

CHARLES W. GERSTENBERG.

New York.

# TABLE OF CONTENTS

## CHAPTER I

### PURPOSES AND FORMS OF BUSINESS ORGANIZATIONS


| SECTION | | PAGE |
|---|---|---|
| 1. | Purposes of Organization | 1 |
| 2. | Risk of Ownership | 2 |
| 3. | Apportioning Control | 3 |
| 4. | Different Forms of Business Organization | 3 |
| 5. | Facility of Formation | 8 |
| 6. | Permanence of Association | 8 |
| 7. | Capital for Large-Scale Organization | 9 |
| 8. | Flexibility of Organization | 9 |
| 9. | Evolution of Business Organization | 10 |
| 10. | Rise and Development of Corporations | 10 |
| 11. | Struggle of Corporation for Supremacy | 11 |
| 12. | Early Corporate Abuses | 12 |
| 13. | Disadvantages of the Corporation | 13 |
| 14. | Advantages of the Corporation | 14 |
| 15. | Place of the Corporation in Modern Business | 15 |
| 16. | Transportation | 15 |
| 17. | Utilities | 15 |
| 18. | Insurance | 16 |
| 19. | Banking | 17 |
| 20. | Manufactures | 18 |
| 21. | Why Individual and Partnership Organization Persists in Manufacturing | 20 |
| 22. | Incorporation in Other Fields | 21 |


## CHAPTER II

### SOLE PROPRIETORSHIP


| | | |
|---|---|---|
| 1. | The Individual and Business Organization | 22 |
| 2. | Who Can Enter Business | 23 |

SECTION PAGE
3. Rights of Aliens . . . . . 24
4. State Restrictions Upon Business . . . . . 26
5. Simplicity of Control . . . . . 27
6. Flexibility of Movement . . . . . 28
7. Secrecy . . . . . 29
8. Stimulus to Individual . . . . . 29
9. Survival of the Fittest . . . . . 30
10. Limited Duration . . . . . 32
11. Individual Credit is Limited . . . . . 33
12. Where Sole Proprietorship is Most Successful . 34
13. Future of Sole Proprietorship . . . . . 34

## CHAPTER III

### GENERAL PARTNERSHIPS

1. History of Partnership . . . . . 36
2. Nature of the Partnership . . . . . 36
3. How Partnerships are Formed . . . . . 37
4. Elements of Partnership . . . . . 37
5. Incidents of Partnership . . . . . 38
6. Right of Partner to Compensation and Share in the Profits . . . . . 39
7. Partnership Agreements . . . . . 40
8. A Sample Agreement . . . . . 41
9. Dissolution of Partnership . . . . . 43
10. Advantages of the Partnership . . . . . 43
11. Example of Partnership Organization . . . 44
12. Some Disadvantages of the Partnership . . . 46
13. Kinds of Partners . . . . . 47

## CHAPTER IV

### LIMITED PARTNERSHIPS

1. History . . . . . 50
2. Essential Features of Limited Partnership . . 50
3. Method of Forming and Terminating Limited Partnership . . . . . 51

SECTION PAGE
4. Form of Limited Partnership Agreement . . 52
5. Rights and Liabilities of Members . . . . 54
6. Advantages of Limited Partnerships . . . . 54
7. Disadvantages of the Limited Partnership . . 55
8. Conclusion . . . . . 55

## CHAPTER V

### SYNDICATES

1. Syndicates Defined . . . . . 57
2. History . . . . . 58
3. Legal Nature of Syndicates . . . . . 58
4. Form of Syndicate Agreement . . . . . 60
5. Administration of the Syndicate . . . . . 61
6. Members Cannot Bind the Syndicate . . . . 62
7. Rules Governing Administration of Syndicates . 62
8. Liabilities of Syndicate Members . . . . . 63
9. Forming a Syndicate . . . . . 64
10. Putting Thru a Deal . . . . . 66
11. Usual Methods of Dividing Liability . . . . 69
12. Method of Settling a Syndicate . . . . . 70
13. Rights of Syndicate Members . . . . . 72
14. Famous Deals . . . . . 73
15. Syndicate Organizers . . . . . 74

## CHAPTER VI

### BUSINESS TRUSTS

1. Popular Meaning of "Trusts" . . . . . 77
2. Original Trusts . . . . . 78
3. History . . . . . 78
4. Purposes of Trusts . . . . . 79
5. Legal Nature of Trust . . . . . 79
6. Liabilities of Trustees . . . . . 80
7. Liability of Beneficiaries . . . . . 81
8. Deed of Trust . . . . . 82

SECTION PAGE
9. Car Trusts . . . . . 83
10. Massachusetts Trusts . . . . . 84
11. Duration of Business Trusts . . . . . 85
12. Form of Certificate of Beneficial Interest . . . 85
13. Kinds of Business Trusts . . . . . 87
14. Voting Trusts . . . . . 89
15. Trusts Within Trusts . . . . . 90
16. Voting Trusts and the Railroads . . . . . 91

## CHAPTER VII

### CORPORATIONS AS BUSINESS UNITS

1. History . . . . . 94
2. Corporations in Modern Business . . . . . 97
3. Corporations Assemble Large Capital . . . . 98
4. Turning a Going Business into a Corporation . . 99
5. Government Business Corporations . . . . 102
6. Public, Quasi-Public and Private Corporations . 104
7. Investors' Classification of Corporations . . . 105

## CHAPTER VIII

### GENERAL ASPECTS OF CORPORATIONS

1. Nature of Corporations . . . . . 107
2. Corporate Powers . . . . . 110
3. Implied Powers . . . . . 110
4. Express Powers of Corporations . . . . . 112
5. Incidental Powers . . . . . 117
6. *Ultra Vires* Contracts . . . . . 118
7. Corporations are Persons, but not Citizens . . 119
8. Classification of Corporations . . . . . 120
9. Foreign Corporations . . . . . 120
10. General and Special Franchises . . . . . 121
11. *De Jure* and *De Facto* Corporations . . . . 122

## CHAPTER IX

### INCORPORATION OF COMPANIES


| SECTION | | PAGE |
|---|---|---|
| 1. | The Corporate Charter | 124 |
| 2. | Special Requirements for Incorporation | 126 |
| 3. | Certificate of Incorporation | 128 |
| 4. | Organizing a Corporation | 129 |
| 5. | Incorporating in Canada | 131 |
| 6. | By-Laws | 134 |
| 7. | Where to Incorporate | 135 |
| 8. | Questions to be Considered Before Choosing a State | 136 |
| 9. | Deciding Upon the State in Which to Incorporate | 139 |
| 10. | Favored Incorporating States | 141 |


## CHAPTER X

### DISSOLUTION OF CORPORATIONS


| | | |
|---|---|---|
| 1. | Duration | 144 |
| 2. | Dissolution | 144 |
| 3. | Voluntary Dissolution of Corporations | 145 |
| 4. | Involuntary Dissolution of Corporations | 146 |
| 5. | Effect of Death of Members and of Bankruptcy | 148 |
| 6. | Corporate Receivers | 149 |
| 7. | Qualifications of a Receiver | 150 |
| 8. | Dissolution in Canada | 151 |


## CHAPTER XI

### STOCK AND DIVIDENDS


| | | |
|---|---|---|
| 1. | Stock | 153 |
| 2. | English Nomenclature | 153 |
| 3. | Classes of Stock | 154 |
| 4. | Certificates of Stock | 155 |
| 5. | Transfers of Stock | 155 |
| 6. | Lost Certificates | 158 |

SECTION PAGE
7. Stock Certificates as Evidence of Stockholders' Rights . . . . . 158
8. Dividends . . . . . 158
9. Who Has the Right to Declare Dividends? . . 158
10. Sources of Dividends . . . . . 159
11. Who is Entitled to Dividends? . . . . . 160
12. Ownership of Dividends on Securities Bought and Sold on the New York Stock Exchange . . 161
13. Dividends on Dissolution . . . . . 163

## CHAPTER XII

### STOCKHOLDERS

1. Rights of Stockholders . . . . . 165
2. Who Has the Right to Vote? . . . . . 166
3. Depriving Certain Classes of the Right to Vote . 167
4. Special Rights to Vote on Certain Questions . . 168
5. Referring Matters to Stockholders . . . . 169
6. How Many Votes Has Each Stockholder? . . 170
7. Between Successive and Between Joint Owners, Who Has the Right to Vote? . . . . . 171
8. Method of Counting Votes . . . . . 173
9. Cumulative Voting . . . . . 173
10. Strategy of Cumulative Voting . . . . . 174
11. Proxies . . . . . 174
12. Right to Maintain Proportion of Control . . 176
13. Form of Negotiable Rights . . . . . 177
14. Right of Bondholders to Subscribe to Stock . . 178
15. Right of Stockholders to Subscribe to Bonds and Notes . . . . . 179
16. Conversion as a Method of Control . . . . 179
17. Control Thru Redemption . . . . . 181
18. Liabilities of Stockholders . . . . . 182
19. Forfeiture of Stock . . . . . 185
20. Kinds of Stock . . . . . 185

SECTION PAGE
21. Authorized Stock . . . . . 185
22. Issued Stock . . . . . 186
23. Unissued Stock . . . . . 186
24. Outstanding Stock . . . . . 186
25. Treasury Stock . . . . . 186
26. Full-Paid and Part-Paid Stock . . . . . 187

## CHAPTER XIII

### MEETINGS OF STOCKHOLDERS

1. Stockholders' Meetings . . . . . 188
2. Place of Meeting . . . . . 188
3. Notice of Meetings . . . . . 190
4. Transaction of Business . . . . . 191
5. Minutes . . . . . 192
6. Form of Minutes . . . . . 192
7. Analysis of Minutes . . . . . 197
8. Quorum at Stockholders' Meetings . . . . 198
9. Conduct of Meetings . . . . . 199
10. British Corporate Meetings . . . . . 200
11. Inspection of Corporate Books . . . . . 201
12. Minorities . . . . . 204
13. Rights of Minorities . . . . . 205

## CHAPTER XIV

### DIRECTORS AND OFFICERS

1. Theory of Corporate Management . . . . 208
2. Number and Qualifications of Directors . . . 209
3. Meetings and Quorums . . . . . 210
4. Powers of Directors . . . . . 210
5. Committees . . . . . 212
6. Officers, and How Chosen . . . . . 214
7. Chairman of the Board and President . . . 214
8. Vice-Presidents . . . . . 215

SECTION PAGE
9. Treasurer . . . . . 216
10. Secretary . . . . . 217
11. General Counsel . . . . . 218
12. Controller . . . . . 218
13. Auditor . . . . . 218
14. General Powers of Officers . . . . . 219
15. Vacancies and Removals . . . . . 219
16. Registrars and Transfer Agents . . . . . 219
17. Organization Charts . . . . . 220
18. Can Directors and Officers Make Contracts with Themselves? . . . . . 220
19. Liabilities of Officers . . . . . 223
20. Compensation of Directors and Officers . . . 224

## CHAPTER XV

### INTERCORPORATE RELATIONS

1. Causes of Concentration . . . . . 226
2. Classes of Combination . . . . . 226
3. Various Forms of Combination Illustrated in the History of One Concern . . . . . 227
4. Trade Associations . . . . . 227
5. Importance, Advantages and Disadvantages of Trade Associations . . . . . 229
6. Example of a National Trade Association . . 229
7. Example of Local Retailers' Association . . . 234
8. Successful and Unsuccessful Undertakings of Local Association . . . . . 235
9. Pools . . . . . 238
10. Steel Pools . . . . . 238
11. Addyston Pipe Pool . . . . . 239
12. Advantages of Pools . . . . . 240
13. Disadvantages of the Pool . . . . . 240
14. Trusts . . . . . 241
15. A Typical Legal Trust . . . . . 241

SECTION PAGE
16. Community of Interest . . . . . 242
17. Types of Community of Interest . . . . . 244
18. Control of an Industry Thru Special Practices . 245

## CHAPTER XVI

### CONSOLIDATIONS, SALES AND LEASES OF ASSETS

1. Meaning of Term Consolidation . . . . . 249
2. Statutory Authority Necessary . . . . . 250
3. Nature of Consolidation . . . . . 251
4. Method of Consolidation . . . . . 251
5. Effect of Consolidation upon the old Corporations 252
6. Effect of Consolidation upon the Status of Creditors . . . . . 252
7. Amalgamation of American Tobacco Company . 253
8. Advantages of Consolidation . . . . . 256
9. Disadvantages of Consolidation . . . . . 257
10. Intercorporate Relations thru Sale of Assets . 258
11. Right to Buy and Sell Assets . . . . . 259
12. Right of Directors to Sell Corporate Assets . . 259
13. Stockholders' Rights to Authorize Sale . . . 260
14. Effect of Sale . . . . . 260
15. Sale as a Means of Concentrating Parts of an Industry . . . . . 261
16. Consideration Paid for Assets . . . . . 262
17. Advantages and Disadvantages of Sale . . . 262
18. Intercorporate Relations formed by Lease . . 263
19. Who can give a Lease of Corporate Assets? . . 263
20. Form of Lease . . . . . 264
21. Consideration for Lease . . . . . 264
22. Who Owns Improvements on Leased Premises? . 265
23. Lease as a Means of Manipulation . . . . 266
24. Other Possibilities for Manipulation . . . . 267
25. Duration of Lease . . . . . 268
26. Effect of Lease . . . . . 268

SECTION PAGE
27. Advantages of Lease . . . . . 268
28. Disadvantages of Lease . . . . . 269

## CHAPTER XVII

### HOLDING COMPANIES

1. Rise of the Holding Company . . . . . 271
2. Magnitude of Interests Involved in Holding Company Control . . . . . 272
3. Classification of Holding Companies . . . . 273
4. Right of a Company to Hold Stock in other Companies . . . . . 273
5. Companies . . . . . 274
6. Ownership of Majority of Stock not Necessary for Control . . . . . 275
7. Why Stockholders Surrender Control of Subsidiaries to Parent Company . . . . . 278
8. Technical Advantages Resulting from Plants Combining . . . . . 279
9. Other Advantages Derived from Combination . 280
10. Advantages of the Holding Company . . . . 280
11. Financial Companies . . . . . 282
12. Management Companies . . . . . 284
13. Complexity of Intercorporate Relations . . . 286

## CHAPTER XVIII

### ILLEGAL COMBINATIONS

1. History of the Common Law of Monopolies . . 288
2. What is the Common Law of Monopolies? . . . 289
3. Violations of the Common Law of Corporations . 289
4. Anti-Trust Statutes . . . . . 291
5. Sherman Anti-Trust Act and Amendments . . 292
6. Meaning of Federal Anti-Trust Laws . . . . 292
7. Trust Legislation in Canada . . . . . 294
8. Federal Trade Commission Law . . . . . 296

SECTION PAGE
9. Clayton Law . . . . . 296
10. Penalties and Suits to Prevent Violation of Anti-Trust Laws . . . . . 298
11. Federal Trade Commission . . . . . 299
12. Power of Federal Trade Commission to Enforce Anti-Trust Laws . . . . . 299
13. The Webb-Pomerene Act . . . . . 300

# ORGANIZATION AND CONTROL

## CHAPTER I

### PURPOSES AND FORMS OF BUSINESS ORGANIZATIONS

1. *Purposes of organization.*—The problem of the present Text is a simple one—a discussion of the ownership of business enterprises. This ownership may be that of a single individual or of a group of individuals. When a group exercises ownership, the members bind themselves together in some form of organization recognized by law and the law prescribes the rights and liabilities of the members.

Whatever may be the rights and liabilities of a business group, whether a partnership, or some one of the less frequent forms of business groups, they will be found in some way to affect business income, the control which the members may exercise in the business and the risk which they assume. Thus, partners may agree to divide profits in equal or unequal shares; and stockholders of a corporation may so divide their profits that some shares receive fairly regular income—perhaps seven per cent on the capital in-

vested—while others receive such irregular dividends as the fluctuating profits of the business may permit.

2. *Risk of ownership.*—Creditors may be considered as potential owners. Let us suppose that Jones borrows $5,000 from Smith to increase his business. If the loan is not repaid at maturity Smith may sue Jones and call upon the sheriff to sell out Jones' business in order to realize the amount due him. In fact, the courts generally look upon bondholders—creditors who have accepted bonds to evidence their loans—as becoming the principal owners the moment a corporation becomes insolvent. In England this idea is carried still further. If a company issues bonds which are known there as debentures, the immediate owners, that is the stockholders, may control the business until the concern becomes insolvent. Then the bondholders act. Their charge against the company, to use the English expression, becomes "crystallized" and they proceed to elect a receiver who takes over from the directors, elected by the stockholders, the full control of the business.

Still holding in mind this idea of creditors as potential owners, and therefore as investors, we can readily see how the risk assumed by owners varies with different forms of business organization. Investors may be ranked according to risks in the following order; creditors of individuals or partnerships, creditors of corporations, stockholders, individual owners or partners. The investor with the least risk is the creditor whose claim is secured not only by the investment

of other owners in the same enterprise but also by the private wealth of those owners. This is the case with the creditors of individuals and of partnerships. If such a business becomes insolvent creditors have recourse not only against the assets of the business but also against the private assets of its owners. Creditors of corporations have their investments secured only by the assets contained in the enterprise. Stockholders take all the hazard of the corporate enterprise, up to a certain point, for if the corporation fails they take the last share of the salvaged remains. But their risk, under ordinary circumstances, is at most limited to their investment in the business since the private wealth of the stockholder is immune from the claim of corporate creditors. Individuals and partners must forfeit to the creditors not only the assets of their business but their private wealth as well. Theirs is therefore the greatest business risk.

3. *Apportioning control.*—Control is almost always complementary to risk. The ownership interest which represents the greatest risk exercises the greatest control, and vice versa. Thus individual and firm proprietors who have the greatest risk have also the active and complete control of their businesses, while creditors generally have only potential or passive control, their risk being at a minimum. Creditors may merely be watchful to see that the active control of the stockholders is not incompetent or injurious, i.e., not unsuccessful or fraudulent.

4. *Different forms of business organization.*—With

the development of business enterprise there has been a gradual evolution in the form of business organization. Various influences and considerations enter into the selection of the business form for any particular business enterprise. The primitive form of business is of course that of the individual proprietor. The individual as a rule operates a small business, usually with limited capital, and is responsible alone for its success or failure. The partnership is the first step towards a wider field of operation and a more complex organization. Often it is a family affair. The business of the individual grows too large for his sole management and he takes his son or some other member of the family into partnership. In other cases two men in the same business unite their capital in order to secure adequate capital for the conduct of their business. Whatever the motive and the circumstances, the partnership is almost invariably a larger business unit than the proprietorship. It is common in retail trade, in the professions, and to a limited extent among manufacturing establishments. As a form of business organization it is losing ground.

The joint stock company is a form of business organization at one time quite frequent in connection with larger enterprises, which, so far as the United States is concerned, is now almost extinct. This form of company was highly popular in England during the seventeenth and early eighteenth centuries. Shortly after the Restoration, in 1660, money became plentiful in England, speculation spread, and joint

stock companies multiplied. With the failure of one of the leading companies in 1720, the South Sea Company, the English government passed the Bubble Act prohibiting the operation of unchartered joint stock associations.

The joint stock company can be best considered as a combination of the partnership and the corporation. It resembled a partnership in that it is formed under a contract, requires no special sanction from the state and pays no license tax. The members are liable, jointly and severally, for all the company's debts. It resembled the corporation in control and management. The members did not control the company but chose a board of directors who were the authorized agents and managers. Thus, while membership in the company might change thru death or transfer of membership interest the company was not dissolved.

Joint stock companies enjoy certain advantages over the partnership. They can acquire larger sums of capital, a greater number of members, and they are not subject to dissolution on the death of members. As compared with the corporation the joint stock company is freer. It may be formed by a contract instead of by filing a certificate, and it is not subject to an annual tax. These advantages, however, are outweighed by the fact that the members have an unlimited liability. The express companies in the United States were the only large companies organized in this form. At the time they were established the laws of New York suggested this form of

organization, and its continuance was chiefly due to inertia.

Cooperative associations represent another form of business organization which has proved more popular in Europe than in America. It is said that the number of such associations is increasing in the United States but they are not, as in England, being used to any great extent in all-round business enterprises. Their functions in this country have been confined largely to marketing or financing. This form of organization is not of sufficient interest or importance to the business world to require consideration in this Text.

The corporation is rapidly becoming the dominant form of organization in American business. The corporation is a creature of law and all its rights, powers and duties are derived from legislation. In some forms of business of a public or quasi-public nature like that of public utilities, railroads, insurance companies, and trust companies it is the only form of business organization which the state will recognize. In other fields of enterprise the corporation competes with other forms of business organization.

Another form of business organization less widely known is the business trust, sometimes called the Massachusetts trust. The main feature of this form of organization is that it is formed by a contract under the common law, and that the title to property and the conduct of business is in the hands of trustees who act for a large group of beneficiaries.

New business forms arise where different enterprises, whether organized in the same form or different forms, unite for a common purpose. The purpose may be temporary in character, giving us the syndicate, or it may contemplate more permanent association, giving us varying forms of combinations, "the trust," the holding company and the like.

The distinguishing characteristic of the syndicate is that it is a temporary alliance of individuals, firms or corporations, usually for the purpose of financing an enterprise. After the purpose of organization has been accomplished the syndicate is dissolved. It is a form of organization used largely by bankers for underwriting purposes. Syndicates reflect the general state of business—when business is expanding they multiply rapidly; when business is at a standstill there is obviously little need for them and few are formed.

Combinations take varying forms. Their primary purpose is to secure the savings and other advantages which result from consolidation and large scale operation. In the first phase such combinations were really "trusts" in the sense above described, except that corporations formed the constituent elements and beneficiaries of the trust. This form of association having been in seven prominent instances declared to be illegal by the courts, resort has been had to other methods.

The practice followed in some cases is to organize a new corporation which buys the individual plants it wishes to bring into the combination and which thus

becomes a single owner of all the establishments. In the largest combinations, however, the stock of the constituent companies is all bought by a unifying company called a holding company. The constituent companies retain their organization intact. They are controlled by the central corporation as a stockholder which has power to elect directors and officers at will and thus have complete power over the management. Tho trusts as combinations of corporations have long ceased to have any existence, popular phraseology continues to use the word trust to designate any large aggregation of capital under unified direction and control.

Before considering the part which these several forms of organization play in the business world it is desirable to fix in mind the chief differences between the two most important primary types, the partnership and the corporation.

5. *Facility of formation.*—Partnerships are formed without any formal agreement. Three or four people get together, place some money in a common fund, and agree to buy and sell goods, each member of the group contributing his skill and service to the enterprise. Here we have a true partnership. There is no need for a contract, for the payment of special organization taxes, or for reports to public officials. As compared with a corporation, one great advantage of this form of organization is the celerity and ease with which it can be formed.

6. *Permanence of association.*—The degree of per-

manence which a form of organization offers is an important question to persons about to organize a business. While a partnership is easily formed it is also easily destroyed since it is dissolved at the death of any partner, or it may be terminated at any time by any of the partners, even tho the agreement states the term during which the partnership shall endure. This is a serious drawback to any organization which looks forward to continuous development.

7. *Capital for large-scale organization.*—The reader is undoubtedly familiar with many of the advantages offered by large-scale production and knows that by means of it products are turned out at a comparatively low cost. Whenever the advantages of large-scale production are especially great this incentive will induce the projectors of an enterprise to select a form of organization that will permit the assembling of sufficient capital to make large-scale production possible. On this account the corporate form is prevalent in iron and steel manufacture while individual ownership has its stronghold in such branches of manufacture as the needle trades where an employe with but little capital may become the boss of his own business.

8. *Flexibility of organization.*—The three elements of ownership are income, control and risk. Other things being equal, that organization will be the most popular which permits of the easiest shifting of these elements among the owners. In this respect the corporation is far superior to all other forms of organiza-

tion. Not only is division of these elements made between the immediate owners and the potential owners —between the stockholders and the bondholders— but in each class the division is carried on almost indefinitely. We find not only common and preferred stock, debenture and mortgage bonds, but a host of intermediate forms of securities invented by business men, each of which makes some new combination of income, control and risk.

9. *Evolution of business organization.*—In early society individual ownership was the prevalent form of business organization and this form has predominated until comparatively recent times. At certain periods other forms of organization have increased in popularity but never to the extent of outweighing in importance the sole proprietorship. It may be remembered that in the seventeenth century, especially after the Restoration in England there were all sorts of companies formed to promote the most hare-brained schemes, besides some that were legitimate, of which latter kind the East India Company was a notable example. Many of these companies lived a brief life and then quickly disappeared. From the year 1720 until 1860 corporations were seldom formed. Even the partnership did not become popular until early in the nineteenth century.

10. *Rise and development of corporations.*—In recent times the history of business organization is practically a record of the constantly growing favor with which the corporation has been regarded. Before

1776 only two corporations had been chartered in the United States and both were insurance companies. Many unchartered associations, however, acting as corporations, had sprung up in the large cities. In this class belongs the United Company of Philadelphia for Promoting American Manufactures. Tho this company was never chartered it issued shares of stock of £10 each and had a board of twelve directors. Between 1800 and 1823, as many as 557 manufacturing companies were formed in eight states, with a combined capitalization of $72,000,000. Over three-fifths of them were organized in New York and Massachusetts.

In the difficulties of American commerce which culminated in the War of 1812, the corporation found an important stimulus, since many of the states, led by New York and Massachusetts, passed incorporating acts to facilitate the formation of manufacturing companies. Perhaps these general corporation acts under which companies can organize by filing their certificates of incorporation, instead of being compelled to secure charters by legislative acts, have constituted the most potent influence in the growth of the corporate form.

11. *Struggle of corporation for supremacy.*—In recent years the corporation has grown immensely in favor. Its progress, however, has not been steady and unimpeded. Even in the early days of Rome popular wrath turned against it as an instrument of oppression and it was abolished. Again, in modern

times the corporate form in England was practically wiped out by the Bubble Act. In the United States at times the corporation has been looked upon with suspicion.

The attack on the United States Bank in 1830 showed a spirit of hostility toward corporations which became widespread. Pennsylvania especially seemed opposed to the granting of charters, since it was felt that the limited liability of corporate members was injurious to those in the same line of business who had risked their entire fortunes. Indeed, the growth of corporations is said to be one of the chief causes for the political decline of protection between 1830 and 1860. Corporations were held to be the instruments of oppression bringing the wealth of the nation into the hands of the few. An opinion of the time was, that "of 21,000,000 people, less than 300,000 are said to own the immense public debt, and nearly the whole of the landed property." [1]

12. *Early corporate abuses.*—That some of the charges against the corporation were well founded cannot be denied. In his "History of Manufactures in the United States, 1607–1860," Victor S. Clark makes the following statement:

> A New Hampshire Senator (1828) recounted in Congress how numerous small stockholders in his state had been robbed of their investments in a million-dollar factory by a few large capitalists who had manipulated the company's

[1] From a contemporaneous statement in the Alabama Legislature. American State Papers, "Finance," V, 849.

affairs so as to secure its property under a mortgage for one-third its cost and then had reorganized.

It was asserted (1858) that a small clique of Boston capitalists by improper methods perpetuated voting control of these corporations, in which they owned a comparatively small amount of stock. They induced stockholders to sign proxies in their favor when they signed their dividend receipts. They also held annual meetings in small rooms to which but a fraction of the stockholders could get access, and called meetings of several companies at different places for the same day and hour, in order to divide the opposition of independent men who owned stock in a number of companies. Less than a score of Boston capitalists were said thus to dictate the fortunes of most of the great manufacturing corporations of the State, and one man was cited who was director of 23 companies and president of 11. The same coterie owned a Massachusetts life-insurance company, which, with a capital of $500,000, controlled nearly ten times that amount of investment funds. Having forced factories by mismanagement to accept loans from this company, they either foreclosed or used their power to depress stock for their own benefit. The other spoils of this control were high-salaried offices and exorbitant agents' commissions.[1]

13. *Disadvantages of the corporation.*—The abuses that Dr. Clark describes were isolated and easily eradicated. There are other disadvantages, however, inherent in the corporate form itself, which will always prove a slight hindrance to organization. In the first place the corporation will, no doubt, always be subject to close supervision on the part of the state. The state will continue to regulate it and to require exhaustive reports of its transactions. Moreover, the state will be likely to lay heavier taxes upon the corpora-

1 P. 460.

tion than upon other forms of organization. And finally the state will limit the corporate form to certain kinds of business. In New York State, for instance, corporations cannot engage in the practice of law, medicine or dentistry.

In small enterprises the corporation will probably continue to operate at a disadvantage since it is "soulless" and those who deal with it will feel the lack of the personal touch and the confidence which exists when the proprietor has his individual property as well as his personal reputation at stake.

14. *Advantages of the corporation.*—The merits of the corporation so far overshadow its drawbacks that today it is the representative type of business institution. Its growth within the past half century has been by leaps and bounds. In the first place its form is flexible. By means of various kinds of stocks and bonds and thru the judicious drafting of charter and by-laws, the control of the corporation can be scientifically determined, the risk equitably apportioned and the income distributed among the owners and creditors.

The corporation assembles huge quantities of capital gathered from many different quarters and then provides the means for efficiently administering it. It secures in this way all the advantages which are a part of large-scale production. Moreover, it possesses a degree of permanence that carries its business on beyond the span of any one generation. It usually outlives the men who make and manage it.

15. *Place of the corporation in modern business.*—A survey of modern business shows the corporation firmly entrenched and constantly gaining ground. In some fields it already has exclusive possession. A brief consideration of the different fields of business enterprise with reference to the relative frequency of corporations in them will bring out more clearly than pages of exposition the varied advantages of the corporate form. It will be seen that first one then another of these advantages has been the determining cause in giving the corporation the place it holds.

16. *Transportation.*—The corporate form of organization is practically the exclusive one in the railroad business. The railroad is a quasi-public corporation, created by the state to perform a function which the state would otherwise have to carry on for itself. These are not powers which could be intrusted to an individual or a partnership where death would bring about a termination of the contract and an interruption of service, because the public, too, is deeply interested in the service. The railroad is subject to very detailed regulation. The service must be performed according to rules which have been prescribed by public authority which in many cases extends even to fixing the rates and fares for the service which the railroad performs. Manifestly the nature and size of the business, the liability involved and the element of duration would make any other form of business organization for a railroad impossible.

17. *Utilities.*—In other forms of business the cor-

poration is almost the exclusive form of business organization. In this group fall the various public utilities. Not only are these enterprises frequently large undertakings which require a large amount of capital which is beyond the means of the individual to furnish; but they perform a service which must, of necessity, be subject to state regulation because of its quasi-public character. Furthermore, the business of a public service company must be continuous and lasting and this requirement neither the individual proprietorship nor the partnership form of organization can provide.

18. *Insurance.*—In the insurance business the corporate form of organization is supreme. This is necessarily so on account of the nature of the business. One of the leading requirements of a life insurance company is that of duration—obviously it must last as long as the persons insured. They must have the assurance that when risks mature, the insurer will be there to pay them. In marine insurance we have the risk scattered and in order to get proper distribution of risk, corporations are formed such as those embraced in the membership of Lloyds. Even in the earliest days of marine insurance an individual or a partnership was not considered strong enough to bear this risk and merchants had recourse to insuring their vessels thru cooperative methods. Fire insurance differs from marine insurance in that the risks are localized. At first this business was carried on in a local way by individuals or groups but as it branched out

and more capital was needed the corporate form of organization became universal.

19. *Banking.*—While there are a number of private banks in the United States, some of them prominent figures in the financial world, the great majority of banks are incorporated. Banking is a business which, like that of public utilities, should be subject to strict regulation on the part of the state. Without this strict supervision disastrous consequences are likely to result as is shown in the failure of so many immigrant banks in New York City and elsewhere. Furthermore, carrying on a large banking business demands large capital and this is secured only by incorporation. Without it the right of issue is withheld and by the majority of banks this privilege is greatly desired. Even in England, the home of the private bank, private banks have declined steadily in number because they could not command the credit once given them in the financial world and for the further reason that they have been in many cases absorbed by joint stock companies with larger capital.

The function of a trustee or an executor of an estate implies a public accounting but does not necessarily imply a public interest. Yet where the trust is to be of long duration or the settlement of the estates likely to be prolonged there is an obvious disadvantage in entrusting it to individuals. This has led to the introduction as trust companies of the more enduring corporation for the performance of these and similar functions. In so far as these companies

engage in the banking business, as they usually do, the same reasons for the corporate form exist as in the case of other banks.

20. *Manufactures.*—In the manufacturing field the corporation has no such manifest advantage as in those thus far considered. Here it is in active competition with other forms of business enterprise, yet it is constantly growing in popular favor. This is plainly apparent from the statistics of ownership of manufacturing concerns in the United States. The table opposite which will throw light on this subject is taken from the census of manufactures for 1914.

The growth in number of corporate concerns has not been so great as that in value of products, which is far more important. A glance at the table will show that the larger industries are incorporating. The corporations, as a matter of fact, employ over three-fourths of the wage earners. Moreover, it is apparent that in recent years the growth of the corporation has been at the expense of the partnership.

In manufacturing, the corporate form has gained ground because it permits doing business on a large scale at a low expense per unit of output. For example, in the manufacture of glass, iron and steel, locomotives, cotton-seed oil, and refined petroleum over 88 per cent of the establishments are owned by corporations. The census of 1914 shows that the entire business of manufacturing rubber belting and hose as well as that of manufacturing sulphuric, nitric and mixed acids, is carried on by corporations. It

TABLE SHOWING RELATIVE IMPORTANCE OF FORMS OF BUSINESS ORGANIZATION

Figures are percentages

| *Character of ownership* | *Number of establishments* | *Average number of wage-earners* | *Value of products* | *Value added by manufacture* |
|---|---|---|---|---|
| Individual: | | | | |
| 1914 | 51.6 | 10.1 | 7.9 | 9.1 |
| 1909 | 52.4 | 12.2 | 9.9 | 11.4 |
| 1904 | 52.7 | 13.8 | 11.5 | 13.1 |
| 1899 | 62.8 | .... | 15.7 | .... |
| Corporation: | | | | |
| 1914 | 28.3 | 78.1 | 83.2 | 81.9 |
| 1909 | 25.9 | 75.6 | 79.0 | 77.2 |
| 1904 | 23.6 | 70.6 | 73.7 | 71.9 |
| 1899 | 13.6 | .... | 65.0 | .... |
| All other:[1] | | | | |
| 1914 | 20.0 | 9.6 | 8.8 | 9.0 |
| 1909 | 21.7 | 12.2 | 11.1 | 11.5 |
| 1904 | 23.7 | 15.6 | 14.8 | 15.0 |
| 1899 | 22.8 | .... | 19.3 | .... |

[1] In 1909 and previous years there was a special classification for firms now included in the group, all other. In 1909 the respective percentages were: establishments 20.2; wage earners 12.0; products 10.6; value added 11.2.

also enables an enterprise to enlist the services of the state in its business in that the concern while being made subject to law secures privileges which it could not obtain under any other form of organization. In contrast, many mercantile establishments prefer to remain unincorporated because they may be free from the detailed supervision by the state and for the further reason that they would secure little additional advantage from incorporation. This is particularly true of many kinds of retail establishments.

21. *Why individual and partnership organization persists in manufacturing.*—Whenever an industry can be started with little capital we may expect to find predominating, the individual type of ownership. Thus in industries ordinarily carried on in cities, such as the needle trades, there are many establishments of this kind. In men's clothing manufacture 52 per cent of the concerns are owned by single proprietors and the greater part of the remainder by firms.

In many industries requiring little capital there is a movement from the ranks of employes into that of employers, as well as a movement in the other direction which becomes accentuated in times of depression. The industries most subject to fluctuating ownership are those that produce unstandardized goods and those in which labor makes up a large part of the cost of manufacture. In tobacco manufacture 82 per cent of the establishments are under individual ownership; in bread and other bakery products, 83 per cent; in broom making, 65 per cent; and in rag carpet manufacture, 75 per cent. In some of the older industries, such as carriage-making, where over 66 per cent of the establishments are individually owned, perhaps the survival of the individual shop is due to inertia.

Wherever the individual form of ownership thrives, we are apt to find also a comparatively large number of businesses controlled by firms. In one department of the needle trades, for instance—the manufacture of women's clothing—the number of establishments owned largely by partnership is over 40

per cent. This is the highest percentage of partnership organization reached in any industry.

22. *Incorporation in other fields.*—There are some fields of business in which the question of duration is so highly essential that the corporate form of organization is chosen in preference to all others. This is shown in the case of cemetery companies, burial associations, etc. In mining, a business which in many cases is only temporary, the corporate form of organization is often chosen because the necessary capital can be most easily secured in this way. A great number of people will subscribe small sums of money which in the aggregate will be sufficient to provide machinery and labor for the proper working of the mine. In forms of business in which the state deems the individual should be safeguarded the corporate form is usually made obligatory. This is the case in employment offices in many states.

Our concern is with business corporations, those organized with capital stock and designed to make profits. With non-stock corporations which occupy an important place in social life we are not concerned.

## REVIEW

Compare the various forms of organization discussed in this chapter as to the degree of risk involved.

What factors should help to determine the right form of organization for any business enterprise?

Select three or four existing organizations and determine whether or not they are of the right form.

Account for the growth in popularity of the corporation as a form of business organization.

# CHAPTER II

## SOLE PROPRIETORSHIP

**1.** *The individual and business organization.*—The sole proprietor who conducts business on his sole responsibility and for his sole profit represents business in its simplest form. He represents one of the types in which business is organized. His case presents no complicated questions since income, risk and control are all centered in him.

We are concerned with the individual as a business man. As such we think of a man not as occasionally concerned with business matters, but as conducting systematically a series of related business transactions for the purpose of making a profit. In thought we may separate this business activity from all his other activities, but in law we cannot do so. If the business is his own, conducted in his own name, he cannot set aside a part of his wealth for this purpose and another part for another purpose and keep them separate, for he will find that whatever wealth he possesses is responsible for the debts of his business.

John Harris we may suppose inherits $50,000 from his father. Half of it he invests in the stock of a manufacturing company and with the remainder he goes into the automobile business. With no business experience he makes a fizzle of the latter enterprise and

is soon in deep water. Pretty soon he is forced into bankruptcy and the assets of the business are insufficient to meet the creditors' claims. Anything he possesses including his stock in the manufacturing company can be levied upon to make up the deficit. There are certain exemptions provided in the law for the purpose of preventing a bankrupt from becoming utterly destitute and a burden on the community. But up to this limit all his property is liable for his debts.

It is needless to point out that if the reverse situation should occur, if the automobile business should prosper, and the manufacturing company fall upon evil days, the creditors of the latter could not, because Harris was a stockholder in the factory, reach out and satisfy themselves with any of the assets of the automobile business. They must be content with what they can realize from the assets of the company.

The unlimited liability of the individual brought out by this illustration is emphasized not only because it characterizes the sole proprietor but because it will be met again when partnership is considered.

2. *Who can enter business.*—In theory any one has the right to conduct any sort of legitimate business enterprise he may desire. There are indeed a few limitations upon the capacity of individuals to make contracts or to control their property and these limitations would naturally prevent such persons from conducting a business enterprise. Contracts made by infants, insane persons and drunkards lack full

validity for the manifest reason that "persons without mind cannot contract for an act of mind required." In the common law there were many restrictions on the contracts made by a married woman tho many of these limitations have been removed by statute.

3. *Rights of aliens.*—Recently, particular interest has attached to the rights of aliens. Aliens are divided into two classes, alien friends and alien enemies. In respect to the former class the laws of the various states are not in harmony. In some states, the organic law entitles resident foreigners to all the rights enjoyed by native-born citizens; while in others, statutes prohibit aliens from holding real property. Some of the latter states discriminate in this respect between resident and non-resident aliens, but others do not. In most states, if not in all, alien friends, whether resident or non-resident, may make enforceable contracts relating to personal property and sue and be sued as long as they are allowed to remain in the United States, but they may be expelled at any time subject to treaty agreement with a foreign power.

Alien enemies have been defined as "residents or sojourners in a country who are citizens or subjects of a hostile state." They cannot maintain an action in the courts without special authority or license, but they may be sued, in which case they are allowed to defend themselves. They cannot enter into valid contracts with citizens which are inconsistent with a state of war. The tendency of modern law is to accord to

alien enemies, who are permitted to remain in a country, all the rights and privileges of alien friends. Their legal position as defined by the President in his proclamation of April 6, 1917, was, that so long as they refrained from acts of hostility and obeyed the laws they should be left undisturbed and be given the consideration due law-abiding citizens except in so far as restrictions were necessary for their own protection and for the safety of the United States.

Partnership contracts entered into with enemy aliens were, as a rule, suspended during the period of the war. With the exception of contracts for royalties upon patents due a resident in an enemy country, in which case a resident agent may be paid, practically all preexisting contracts are dissolved by war. As to trading contracts, public policy demands that any contract,the performance of which is inconsistent with a state of war, should be suspended or invalidated.

In Canada, in the Province of Quebec, it has been held that an alien enemy on being released from an internment camp could proceed with an action which had been instituted prior to his internment and suspended during that time. The alien was assumed to have become again a law-abiding alien enemy. Under the Governor General's proclamation to aliens at the outbreak of the war, as interpreted by the higher courts, a resident alien enemy in Canada who peacefully pursued his usual vocation might contract and seek the assistance and protection of the courts.

4. *State restrictions upon business.*—While we have seen that in theory an individual may enter any sort of business which he desires, he finds that in practice his freedom is restricted both by law and custom. The state reserves to itself a right known as the police power which enables it to take such action and pass such laws as it deems necessary for its own protection and for the safety, comfort and welfare of its citizens. There are no limits to this power in so far as it is exercised for the above purpose, and the present tendency is to enlarge the scope of this power rather than to restrict it.

In its exercise of the police power the state among other things aims at supervision and regulation of those forms of business which are connected in any way with the social welfare—the public health, the public morals, and the public safety and comfort. When an individual, a firm, a corporation or any other form of business organization entered the liquor business the states as a rule have maintained a very close supervision over the business for reasons of public policy and often for fiscal purposes as well. In certain forms of business such as pool and billiard rooms, cafés and theatres the state protects public morals by requiring such places to take out some form of license which may be revoked at any time by reason of the failure of the proprietors to comply with specified regulations. The state, for sanitary reasons, requires all persons engaged in the manufacture and sale of foods to obtain a license before engaging in business.

In time of war, military necessity and public policy require that the police power be greatly extended. It then may be made to cover such things as the manufacture and sale of food products, munitions of war, ships, basic commodities of manufacture, and even whole industries such as transportation and mining. At such a time any business or industry which in any way touches upon the manufacture, sale and delivery of commodities which are necessary to a nation at war is brought under the police power.

The taxing power of the government also restricts business activity. The thoro-going supervision of the United States Internal Revenue Service of every step in the manufacture and sale of distilled and fermented liquors had its origin solely in the collection of the national revenue. For a like motive, the manufacturer of tobacco, cigars and cigarettes is subject to a high degree of inspection. In some of the taxes and regulations imposed on business it is often difficult to see where the taxing power ends and where the police begins. But both are adduced as reasons for restricting the private exercise of business.

5. *Simplicity of control.*—Like all other forms of business organization, the sole proprietorship type possesses certain advantages and disadvantages which have led to its adoption or rejection by those about to engage in business enterprise.

In the first place an individual possesses the free right to make contracts since he stands ready to back up his obligations with his wealth. He asks no special

privileges from the state when he enters business. On its part the state does not require the individual to pay a special organization tax, nor submit to any visitorial powers, except, as we have seen, in those businesses over which, on account of public welfare, it sees fit to exercise the police power.

The individual in business is unhampered. He can at will discontinue his business and direct his energies into other fields. Moreover, his business in its administration needs no elaborate system to keep it in operation. In most cases the principal activities are well coordinated in the mind and memory of its owner.

6. *Flexibility of movement.*—Two heads are better than one, but on the other hand too many cooks spoil the broth. Every business man within his own experience recalls instances of partnerships wrecked because of personal incompatibility. In emergencies an individual being responsible to no one but himself can act quickly and decisively. This can be done less rapidly by a partnership and perhaps still less readily by a corporation. When he sees an opportunity the individual is free to enter lucrative side lines or auxiliary occupations. While this may lead to scattering of energy as well as of resources it must be remembered that with some notable exceptions, the sole proprietorship is suited best to small enterprises and is perhaps most frequently used as a stepping stone to other and larger forms.

That individuals do depend very largely on side lines to augment their earnings is borne out by ex-

perience. A German census taken in 1895 shows that about one-sixth of the people engaged in gainful occupations did not rely entirely upon one occupation but chose a second to round out their incomes.[1]

7. *Secrecy.*—The individual, as a competitive business unit, can make the most of the advantage of his sole proprietorship by keeping secret the means whereby he improves his production, saves in purchasing or increases his sales. This element of secrecy is important since it gives to business alluring opportunities for the use of strategy. It makes business a game, thus holding and increasing the interest of the owner. In many lines where competition is close, and the margin of profit is small and dependent upon constant improvements in machinery and productive processes, it is not unusual to find a well developed system of espionage, which indicates more closely than anything else can do, the importance of the secrets that are so eagerly hunted.

8. *Stimulus to individual.*—Perhaps the strongest card held by the sole proprietorship is that it truly reflects the skill and ability of the individual. Furthermore, in the income which the individual gets from his business he receives the most effective incentive to develop still further these traits which have made him successful. No measure of success is so convincing as a growing bank balance.

The noted economist, Dr. F. W. Taussig, illustrates this principle of direct gain as a stimulus to

1 Bucher's "Industrial Evolution," p. 260.

individual effort in a story of the beginning of Edison's career.

It is related that his first invention was a device for registering promptly and automatically the votes of a legislative body. Each member had only to press a button, and in a jiffy the count pro or con would be recorded. The proud young inventor gave a successful demonstration before a committee of the National House; but an experienced legislator poured cold water on his enthusiasm with the remark: "Young man, if there is any invention on earth that we don't want down here, it is this. One of the greatest weapons in the hands of a minority to prevent bad legislation is filibustering on votes, and this instrument would prevent it." And, as the biographer tells us—he was Edison's close associate and derived his information from the inventor himself—"Edison determined from that time forth to devote his inventive faculties only to things for which there was a real, genuine demand, something that subserved the actual necessities of humanity." And, it must be added, that thruout his subsequent career, clear as it is that the man was possessed with an instinct for contrivance, he was also never indifferent to money. All his inventions were patented; no pretense is made in his biography that pecuniary return was immaterial. True, the pecuniary management seems often to have been bad. Had Edison been a great business manager as well as a great inventor, his fortune might have overtopped even the most amazing known to us. But it seems to have been lack of pecuniary ability, not the absence of pecuniary motive, which caused him to rank among the common ruck of millionaires.

9. *Survival of the fittest.*—Another advantage of individual control in business—an advantage that accrues to society more than to its individual members—ought to be mentioned at this point. The direct relation between ability and incompetency on the one

hand, and gain and loss on the other, constantly tends to make individual proprietors move rapidly forward, or to be relegated quickly to the ranks of labor. The struggle for existence is severe; it insures a speedy elimination of the unfit. Progress marches, indeed may be almost said to gallop, in seven-league boots. And there is a degree of certainty about the selection of the fit among individual proprietors that is quite impossible in the more impersonal forms of organization. John Brown's voice, his handshake, his face, even his gait, makes me like or dislike him and helps to determine whether or not I shall make my purchases in his store. On the other hand, the A. B. C. Company is impersonal, remote and makes no appeal to me as an individual.

That this personal element in business is often vital to success is well illustrated by Dewing [1] in his history of the malting business.

> The malting business is such that competition cannot be suppressed. The founders had been uniformly very prosperous on account of their familiarity with the business, attention to detail, their thrift, perseverance and their pride in success. To a large extent these conditions were inherited by the second and third generation of maltsters, many of whom had risen to some local prominence and were aspiring to local social or political positions. At all events, the younger men attended carefully to the details of the malt business they had inherited, and even tho they may not have possessed the administrative ability of the earlier generation they succeeded in holding their own positions with the local brewing trade, and in conducting the malt house with profit.

1 "Corporate Promotions and Reorganizations," page 294.

After the establishment of the American Malting Company, the brewers found that they were no longer dealing with the same malt house that had furnished them with malt for years. On the contrary, their malt now came from the "Milwaukee branch" of the "trust" and their business dealings were restricted to hired salesmen. They preferred the older, more personal, albeit more inefficient, method of doing business and easily found grounds of complaint. "The 'trust' is using poorer barley," or "The 'trust' can't make as good malt as ————————." Provoked by the new conditions, the brewers turned to the small proprietary malt houses, the owners of which, stimulated by the aggressive policy of the American Malting Company, made every effort to increase their sales among the dissatisfied brewers. To make matters worse for the Company, it was discovered that the original contract, by which the selling maltsters agreed not to go back into the business for a period of years, could not be enforced at law. As a result many of the old maltsters, having disposed of their stocks in the American Malting Company, built new and improved malt houses and solicited the trade of their old customers.

10. *Limited duration.*—Probably the most important disadvantage of sole proprietorship is the obvious one that it is limited to the life of the individual. The life of the individual is the most important element in the business. When it is lost the business is either wound up, or it is incorporated and its functions divided among several persons. The distribution of various functions in business among different individuals creates an organization that outlives any component part. While it may be difficult to find a good sales manager, for example, it is almost impossible to find a person who combines all the qualities required

by the producing, marketing and financing functions of a growing enterprise.

While a proprietor may employ highly paid experts in various departments to advise him, it is doubtful if this can be as effective as a system composed of several able men, all interested in the success of an undertaking. This weakness in the sole proprietorship often induces men to conduct their business under a trade name. They feel that in this way they gain standing in the community and thus improve their credit. Usually, to use a trade name, the proprietor is required by law to file a certificate in a public office in order that those dealing with the business may know the responsible person. When such a person sues or is sued, his own name and not the name of the business is used. If he takes title to land he should do it in his own name. The state takes the position that altho it recognizes the use of a business name it does not recognize the business as entirely distinct from the person owning it.

11. *Individual credit is limited.*—Except in the case of spendthrift trusts, there is no means known to the law which enables the individual to escape liability for his debts, however incurred. His eggs are all in one basket. If his business is small, this unlimited liability will be an advantage in getting credit. His creditors will appreciate his willingness to assume all risks; he thereby shows his faith in his business. Therefore, if a small business is incorporated, credit-

ors are likely to demand that the responsible individual get from behind the corporate shield of limited liability and assume liability by guaranteeing payment.

On the other hand, in large businesses, this very unlimited liability prevents the individual from aggregating large sums of capital. If a person has a successful patent and needs capital to develop it, the chances that this undertaking will be ruined by some other and less fortunate venture of the owner are sufficient to deter investors from intrusting their capital to him. Of course, the patentee would incorporate a company to take over the patent.

12. *Where sole proprietorship is most successful.*—The United States census gives the average value of products per establishment in 1914 as $258,174 in the case of those operated by corporations; $38,835 in the case of those operated largely by firms and only $13,518 in the case of those operated by individuals. The small concerns are the natural pastures for the individual. The sole proprietor seems to thrive best in occupations requiring exceptional skill and in those where machinery cannot be used to good advantage. The farm owned and run by an individual is perhaps one of the best known examples of sole proprietorship.

13. *Future of sole proprietorship.*—In individual proprietorship the control, risk and income all center in one individual. We have seen that the amount he can borrow is almost negligible as compared with the large funded indebtedness of the corporations. The

tendency is, however, for this form of organization with all its advantages and disadvantages to continue to be the form of business organization chosen by small pioneer enterprises and those depending chiefly on skill rather than on aggregation of capital.

## REVIEW

What are the legal restrictions placed upon a person who seeks to enter business?

In what sort of enterprise is the form of individual ownership advantageous? Why?

Is there a bigger opportunity for the individual to display his skill and ability in his own business than in any other form of organization?

Why is it that when a business is small, the individual owner usually finds it easier to get credit than the corporation, but as business grows larger, the individual finds it more difficult to get credit than the corporation?

# CHAPTER III

## GENERAL PARTNERSHIPS

1. *History of partnership.*—In no way can one better learn to appreciate the modernity of strictly business associations than by studying the history of partnerships. While such cooperative groups as families, clans and guilds have existed for many centuries, they have had more than a strictly business foundation. But the business partnership, the association of men for a purely business end, is hardly more than a century old. Blackstone, whose commentaries on the law first appeared in 1765, does not discuss them.

The fact is that partnerships did not have an early start in England. They began in the trading nations of Holland and Italy. The English law of partnerships is an ill-assimilated mixture of Roman Law, of the Law Merchant and of the Common Law of England.

2. *Nature of the partnership.*—Even in this day the true nature of the partnership is not agreed upon by jurists. Is it an entity or is it a collection of individuals? From the standpoint of partnership law it is important which view is taken. In order to make law conform to justice, courts sometimes state that the partnership is an entity, and that the question in

hand is to be settled on that basis; at other times, however, we find courts denying the existence of a separate entity.

3. *How partnerships are formed.*—In some of the continental countries of Europe, partnerships must be founded upon a written agreement. In England and America, however, an oral agreement is sufficient. Indeed, in order to protect third persons, courts frequently construe a partnership relation from the acts of two parties, even tho they may have expressly agreed with each other that they shall not be partners. Thus, Jones lends Smith money to enable him to pursue his business. Jones becomes interested, spends time at Smith's office, permits employes to refer to him as one of the "bosses," and generally takes no pains to let creditors know his true position. Now if Brown, relying on all these signs of partnership, and without knowing the true agreement between Jones and Smith, gives credit to the concern, relying on the fact that Jones is responsible and is a partner, Jones will not be permitted to deny that he is a partner.

4. *Elements of partnership.*—If Jones agrees with Smith to be Smith's partner, the partnership relation will arise. Nothing more is necessary, unless certain acts are to be done by the parties before business is begun. If, however, no express agreement exists, written or oral, a partnership relation will not be presumed by the courts unless the following conditions can be found, (1) The parties must engage in business; mere cooperation for philanthropic purposes is

insufficient. (2) They must divide profits and losses (3) Each must have a voice in the business. (4) There must be on the part of each an actual investment of time, money or property. Thus an agreement between two concerns to conduct their respective businesses in a certain way would be a *pool* but not a partnership since the arrangement does not contemplate any form of investment in a common fund.

5. *Incidents of partnership.*—A consideration of the legal incidents of the partnership relation will make clear the advantages of this form of organization as well as the essential differences between it and the corporation.

The most important incident is that of unlimited liability of members. One partner may be a merchant prince, the other a pauper. In that case all the financial burden will fall upon the former. In case of failure he cannot save his private estate by claiming that his creditors are taking more from him than from his partner. While the individual property of the members of a partnership which has failed can be taken by the individual creditors of the respective partners, any surplus beyond what is necessary to pay these claims must go into a common fund to meet the demands of the partnership creditors.

Each member of a partnership has full authority to bind the firm and to order its affairs. In this respect it may be said that the whole is no greater than any of its parts. In legal parlance this rule is stated thus, "Each partner is a general agent of the partnership

within the scope of the partnership business." In ordinary matters a majority may decide the partnership's line of action. If the firm has an even number of partners and they become evenly divided on a question, the question must remain open.

Finally, the partnership relation is a personal one, and each person has the right to select his copartners. To illustrate, if all of A's property is subject to the payment of firm debts, and if this hazard is to be brought down as a real liability upon A, thru the acts and decisions of B, his partner, who has full authority to bind the partnership, A will want to retain the right to veto any attempt of B to pass his partnership interest to another. B may be shrewd and industrious but his son may be stupid and a profligate. If B attempts to transfer his interest to his son whether by sale, gift or testament, he will convey merely the property value of his interest. A will have the right to render an accounting to the transferee and to get rid of him by paying him the cash value of B's interest.

6. *Right of partner to compensation and share in the profits.*—Partners go into business for profits. Even tho one invest more than another, profits will be divided equally in the absence of a specific agreement to the contrary. Upon dissolution, the profits and losses are apportioned in accordance with this rule, each partner receiving first the capital he invested, or such portion of it as is left after the losses have been made good. Partners are not entitled to

interest on capital invested, nor are they entitled to additional compensation for extra services rendered; even tho the extra services are those of a surviving partner winding up the business. Every partner, however, has a right to a contribution from his co-partners for all expenses that he incurs in the exercise and protection of the firm's business. The rules here stated may be changed by express agreement, but they govern where no such agreement exists.

7. *Partnership agreements.*—It will, of course, be understood that no partnership business of any magnitude is conducted merely on an oral agreement. Its foundation is a formal contract between the parties. While a general partnership agreement may contain clauses which are applicable only to the business in question, there are certain clauses which are essential to all partnerships of this kind. The agreement usually gives first the date, the parties to the agreement and the state in which they reside. This is followed by the purposes of agreement in which is set forth the class of business, whether wholesale, retail, manufacturing, buying and selling at wholesale or at retail, or what not, which is to be conducted and the general nature of the goods to be manufactured or traded in. The period for which the partnership is formed is the next clause. This is followed by the investment clause in which is given the amount which each partner contributes and the general purpose for which the capital is to be used. A clause to the effect that each partner shall devote himself solely to the furtherance

of the business is often inserted at this point. Other sections are usually given over to a statement of how profits and losses are to be shared, how books of account are to be kept and the times when an accounting is to be made. The agreement concludes with clauses dealing with how the business is to be terminated, including a statement on division of profits. The agreement is then made binding by each of the partners "affixing his hand and seal."

8. *A sample agreement.*—The general nature of the partnership contract in written form being understood, the form which this agreement takes can be best explained by a sample agreement such as that which follows:

This agreement, made this 10th day of July, 1916, by and between Alexander Blickmore, Charles Dennison, Edward Farrel and George Hamilton, all of the City and State of New York, witnesseth:

That said Alexander Blickmore, Charles Dennison, Edward Farrel and George Hamilton shall associate themselves together in the trade of buying, wholesaling, and retailing all sorts of goods, wares and merchandise belonging to the trade and business of dry goods merchants.

That said partnership shall continue from the date of this agreement for and during the term of ten years next ensuing.

That to this end and purpose the said Alexander Blickmore has contributed as stock the sum of ten thousand dollars; and the said Charles Dennison the sum of ten thousand dollars; and the said Edward Farrel the sum of ten thousand dollars; and the said George Hamilton the sum of ten thousand dollars; to be used, invested, and employed in common between them to their general advantage in the management of said business.

That said parties shall not, at any time hereafter use, follow, or exercise said business or occupation, or any other, during said term, to their private benefit or advantage, but shall, at all times during said term, with their utmost skill and ability, conduct and act only for their mutual advantage with said stock and for its increase.

That said parties shall discharge all rents and expenses of said business equally between them.

That all profit, gain, and increase that shall arise by reason of said joint business shall be equally divided between them, share and share alike.

That all losses and decrease that shall happen in said business, by reason of bad debts, or otherwise, shall be borne and paid equally between them, share and share alike.

That there shall be kept, during said term and joint business, just and true books of account, wherein each of said partners shall enter and set down the money by him received and expended, the goods, wares and merchandise by him bought and sold, and all other matters and things concerning said partnership, so that any of said partners may at any time have free access thereto.

That said partners shall, once every three months, upon the request of any one of them, make and render to each other, or his legal representatives, a true and perfect account of all profits and gains by them made, and of all losses sustained; and also of all receipts, disbursements, and other things whatsoever concerning said partnership, and thereupon shall cancel, adjust, pay, and deliver unto each other their equal shares of the profit so made, if any.

That at the end of said term of ten years (if said partnership be not sooner determined, in which case) the said partners, or their survivors, shall make a final and true account of all things as aforesaid, and in all things well and truly adjust the same.

That upon making account of stock, goods, wares, and merchandise, and the profit, gain and increase thereof which remain, the same shall be equally divided between them, or their survivors, share and share alike.

IN WITNESS WHEREOF, the parties have hereunto set their hands and seals the day first above written.

ALEXANDER BLICKMORE (Seal)
CHARLES DENNISON (Seal)
EDWARD FARREL (Seal)
GEORGE HAMILTON (Seal)

9. *Dissolution of partnership.*—As will be inferred a partnership will cease by any act that would tend to convey any partner's rights to another. The insolvency, death or insanity of any partners, therefore, terminates the relation. Other causes would include agreement of the parties, expiration of the time agreed upon for continuance, insolvency of the concern and war between nations, certain citizens of which have entered into a partnership agreement.

10. *Advantages of the partnership.*—Many of the advantages held by the sole proprietorship are likewise applicable to the general partnership. The partnership is easy to form and is applicable to a large number of industries. The partners have the same right as the individual to change their business plans without securing legislative consent. This form of business organization can at any time be adjusted to meet changing business conditions.

There is also the same strong incentive to tend to business as is found in the sole proprietorship. But the partnership, being able to command more capital, is capable of doing business on a much larger scale than in the case of the sole proprietorship. It is possible also, under this form of business organization, to

so divide the functions of the managers as to secure all the advantages, in this one respect, that is secured by the corporation, tho the organization of the management will not be effective to bind outsiders who make contracts with a partner, relying on his power of general agency, unless the division of partnership powers is brought to the actual attention of the outside person concerned in the transaction.

11. *Example of partnership organization.*—The Baldwin Locomotive works of Philadelphia until its incorporation in 1909 was said to be the largest partnership in the world. The business was founded in 1831 by Matthias Baldwin and passed thru various stages of development until six partners formed the organization. Two of the senior partners were not very active in the conduct of the business. Of the remainder, in theory, one partner had charge of finance, one of making contracts, office management and other matters pertaining to the running of the business, one of designing and one of the works; in fact there were no titles. All the partners were on an equality and the business of each department was handled on the basis of agreement; that was the business organization. Meetings were held weekly, sometimes oftener, when questions of business policy were thrashed out.

In speaking of the advantages of this form of organization, Mr. Alba B. Johnson, one of the partners, made the statement that in their firm each partner was able to settle quickly the thousand and one ques-

tions coming up in his department each day. If it were necessary for him to consult another partner it could be done instantly. This advantage of the partnership Mr. Johnson contrasted with the corporate form of organization in which a board of directors holds the power and must have all matters submitted to it by the president before any action can be taken. Moreover, Mr. Johnson claimed that in the corporate form of organization each official—the secretary, treasurer and general manager—had his own province and was jealous of all other officials.

There is no doubt but that the first contention bears a great deal of truth. Large corporations may throw so many limitations about their officials that these men are hampered in the performance of their duties. But there is no reason to suppose that the officials of a corporation may not be entrusted by the directors of the corporation which employs them with the same amount of authority that the members of a firm possess. The most successful corporations are those which have first tested their minor officials and having satisfied themselves that these officials are fitted to exercise authority, permit them to do it to the utmost.

The second contention that there is more envy and jealousy of prerogatives among officials in a corporation than in a firm in which all are equally interested has little basis in fact. One of the hardest things to obtain in a general partnership is harmony among the members. Human nature changes little whether it is in a partnership or a corporation and there is

likely to be as much jealousy and dissension in one form of organization as in another. In the Baldwin organization the functions were well divided among the members and there was no friction. Members of the partnership at that time had contributed nothing but their ability as shown over a long period of service. This was probably the secret of the long continuity of this concern as a firm—the members had undergone a long probationship before becoming members.

With the decrease of business the working force of Baldwin's was greatly reduced in January and February, 1908; and in June of the next year the business was incorporated. The reasons given for the change in organization were that the members of the firm desired to place their property in a more modern form and to facilitate the transaction of business and the convenient adjustment of affairs in case of death of any of the owners.

12. *Some disadvantages of the partnership.*—One disadvantage under which the partnership labors is that because it is so easily dissolved and because the legal complications attendant on its dissolution are so serious, it is impossible for this form of business organization to borrow on long-term credit. The capital, therefore, that partners can borrow is limited and the terms expensive. Moreover, the need for harmonious action is so great that unless the members can be persuaded to agree to conciliatory and deferential action, as in the case of the Baldwin Locomotive Works, the partnership is not likely to survive very long.

13. *Kinds of partners.*—In addition to the general partners who have thus far been considered there are a number of other relations to the partnership which sometimes exist and which should be understood.

(a) Silent partner.—The silent partner has a right to a share in the profits of the firm but no voice in its management. He is liable for obligations of the firm in the same way as the other partners. If he withdraws from the firm he must give notice to escape any liability in the future. The agreement which the silent partner makes by mutual consent with the other partners cannot be allowed to mislead a third person who believes he is dealing with a member of the firm.

(b) Dormant partner.—A dormant partner has an investment in the business as a partner but his connection with it is secret. He has no part in the management of the business and if at any time his identity is disclosed he becomes liable as a general partner. He can become a general partner at any time and take part in the management of the business. He is at liberty to retire from the business without giving notice to those persons who do business with the firm and he cannot be held for any actions of the firm subsequent to his withdrawal.

The dormant partner has a business relationship of little value. If he is discovered at any time he becomes the same as any other partner.

(c) Secret partner.—A secret partner as the name implies is one whose connection with the firm is con-

cealed from the public. In reality he is a partner as much as any member of the firm.

The terms dormant partner, silent partner and secret partner are often used interchangeably. There is this difference, however—a dormant partner must be both secret and silent while a silent partner need not be secret. On the other hand, while the dormant and silent partners have no voice in the management of the business, the secret partner has as much authority as the general partner.[1]

(d) Nominal partner.—Finally there is the nominal partner. He has no interest in the business but merely allows the use of his name. This makes him subject for all the liabilities of a partner but gives him none of his advantages. He is like a person who indorses the note of a firm or gives them assistance otherwise in order to bolster up their standing or enable them to appear in a more favorable light in the business world.[2]

It is clear that the characteristics of each of the partners above described rests upon an agreement made with the other partners. The relationship described by the several terms is one of fact, not of law. They are all in law general partners and liable as such no matter what restrictions on their active participation in the firm's affairs they may have consented to. A consideration of these cases emphasizes again the fact that in a partnership formed wholly under common

[1] "Partnership Relations" by Thomas Conyngton, p. 60.
[2] "Partnership Relations" by Thomas Conyngton, p. 60–61.

law rules, no act of the parties can excuse any of them from the liability which the law imposes.

This general liability of each partner with his personal property for the debts of the firm together with the fact that each partner is a general agent for all the others is the essence of the partnership relation. In short a partnership so far as the liability of its members is concerned simply aggregates that which they would have as separate individuals.

## REVIEW

What conditions must exist to constitute a partnership and to establish the legal liability of each member of the firm?

Why should all partnership agreements be reduced to writing? What are the main points to be noted in an agreement?

What is the difference between the general partners and each of the following—the silent partner, the dormant partner and the secret partner?

What is meant by the statement that the characteristics of the different kinds of partners are of fact and not of law?

A and B are partners. A orders a mahogany desk from a dealer C. Then B tells C to deliver an oak desk instead of a mahogany desk. What should C do?

## CHAPTER IV

### LIMITED PARTNERSHIPS

1. *History.*—Tho the limited partnership came into general use only recently, its history is perhaps more ancient than that of the ordinary partnership. It is undoubtedly an outgrowth of the Roman Law which provided that one or more persons might turn over property to a slave and avoid personal liability by trading thru him. Gradually there grew up in the civil law the rules governing this form of business, substituting of course for the slaves free persons who became general partners with unlimited liability. Louisiana, which uses the civil instead of the common law, recognized this form of organization; in 1822 the principal rules which grew up in the civil law were codified and enacted into a statute by the State of New York. New York's lead has now been followed by most common law jurisdictions tho England did not fall into line until 1907.

2. *Essential features of limited partnership.*—In a limited partnership the partners are divided into two classes: general partners who are liable for all firm debts, and special partners whose liabilities are limited, usually to the amount of their respective contributions to the firm. As far as the outside world

is concerned the general partners are in effect the firm. They are the active managers and also can direct and bind the concern. Their names alone can appear in the firm name. When the firm is sued or wishes to sue, the general partners' names alone appear in the title to the action. Indeed, while in the ordinary partnership, the members could not sue the firm since they would in effect be suing themselves, this rule applies in a limited partnership only to the general members. They can enforce their claims against their own firm only by going into equity and getting an accounting. These difficulties do not stand in the way of the special partners, since if they wish to sue the firm they use only the names of the general partners as defendants.

3. *Method of forming and terminating limited partnership.*—The limited partnership exists by statute and not by common law; it is formed by the filing of a certificate. Moreover the provisions of the statutes and the agreements contained in the certificate must be strictly observed or the special partners will forfeit their limited liability and become general partners. Indeed, while the limited partnership may be dissolved for any of the causes applicable to ordinary partnerships, an additional cause is interference in the operations of the firm by a special partner or failure of any special partner to live up to his obligations. Thus if any one of two or more special partners interferes with the business, or withdraws the capital he has contributed in pursuance of the certifi-

cate provisions, the whole partnership loses its limited character and all the members become liable as general partners.[1]

4. *Form of limited partnership agreement.*—The following illustrates the form of a certificate of limited partnership in the State of New York:

We, whose names are severally undersigned, are desirous of renewing and continuing, and we do hereby renew and continue, beyond the time fixed for its duration, the limited partnership which was heretofore formed and now exists under us, under the name or firm of Post and Flagg,[2] by making, severally signing and acknowledging, and causing to be filed and recorded in the Clerk's office of the County of New York, in the State of New York, this certificate by which such part-

[1] Limited partnerships are recognized in Canada. In all the provinces, the filing of the certificate is of course absolutely essential. There can be no dissolution of such partnership before the time mentioned in the certificate until a notice has been filed in the office where the original certificate was recorded, and in Ontario it must also be published once each week for three consecutive weeks in the local newspapers and in the *Official Gazette*. The general principles underlying all limited partnerships are here well stated.

[2] It should be noticed that this certificate was executed for the purpose of renewing and continuing an old partnership which had consisted of two partners, Post and Flagg. Where a new partnership is formed the firm name should contain the names only of the general partners. Section 20 of the Partnership Law (Chapter XXXIX of the Consolidated Laws of the State of New York), provides in part: "Where any limited partnership shall hereafter be formed under the laws of this State, it may use the firm or corporate name of any general or limited partnership or of any corporation, domestic or foreign, which may theretofore have carried on its business within this State, where said general or limited partnership or corporation is discontinued or shall be about to discontinue its business within the State, and where a majority of the partners, general or special, in either of such last mentioned co-partnerships, or of the survivors thereof, shall be members of such co-partnership theretofore existing, or of the surviving members thereof, or where stockholders holding a majority of the stock of such corporation shall consent in writing to the use of such firm or corporate name by such new co-partnership."

nership is renewed and continued, pursuant to "An Act in relation to partnership, constituting chapter thirty-nine of the Consolidated Laws," and we do hereby certify and state:

I. That the name or firm under which such partnership is to be conducted is Post and Flagg, and that the county wherein its principal place of business is to be located is the County of New York.

II. That the general nature of the business intended to be transacted is a general commission and brokerage business, including the dealing in stocks, bonds and other securities, as generally carried on in the City of New York.

III. That the names of all the general and special partners interested therein (all of whom are of full age) and their respective places of residence are as follows, to wit:

George B. Post, Jr., who is a general partner, and who resides at Bernardsville, Somerset County, State of New Jersey.

Arthur Turnbull, who is a general partner, and who resides in the City and County of New York.

Benson B. Sloan, who is a general partner, and who resides in the City and County of New York.

Alfred L. Dennis, who is a general partner, and who resides in Newark, Essex County, State of New Jersey.

Neville G. Higham, who is a general partner, and who resides in the City and County of New York.

Henry Shaw, who is a general partner, and who resides in Morristown, Morris County, New Jersey.

Nathaniel L. McCready, who is a special partner, and who resides in the City and County of New York.

IV. That the amount of capital which Nathaniel L. McCready, the special partner, has heretofore contributed to the common stock of said limited partnership is the sum of three hundred and fifty thousand dollars ($350,000), which he paid in cash, and that the said amount, namely, three hundred and fifty thousand dollars ($350,000) has been contributed by the said special partner to the common stock of the partnership as renewed and continued.

V. That the time for which the said limited partnership

is to be renewed and continued is five (5) years from December 31, 1910—on which date such renewed and continued partnership is to begin—to January 1, 1916, and that the time at which, as so renewed and continued, it is to end is December 31, 1915.

In witness whereof, we have hereunto set our hands and seals this thirtieth day of December, 1910.

GEORGE B. POST, JR. (L. S.)
ARTHUR TURNBULL (L. S.)
BENSON B. SLOAN (L. S.)
HENRY SHAW (L. S.)
NEVILLE G. HIGHAM (L. S.)
ALFRED L. DENNIS (L. S.)
N. L. MCCREADY (L. S.)

(Acknowledgment)

. . . . . .

5. *Rights and liabilities of members.*—General partners have all the rights and liabilities of the members of ordinary partnerships. Special partners have no voice in the business, and must contribute the capital they have agreed to subscribe. They are not lenders of money and therefore can verify the account and inspect the management; they have a right to profits and not to fixed interest; but they cannot prove their claims as creditors upon the bankruptcy of the concern.

6. *Advantages of limited partnerships.*—Frequently a wealthy man will aid a friend or relative by becoming a special partner in a limited partnership. Thus, increased capital is acquired without imposing unusual liabilities on the investors if they are in no way responsible for its management. This form of organization is the first to be studied which provides

a means for separating the elements of control, income and risk. Moreover, a limited partnership is usually free from governmental control, tho this advantage may at any time be lost since the organization is a statutory creature, and therefore subject to the visitorial power of the state. The state has not as yet, however, seen fit to exercise that power generally.

7. *Disadvantages of the limited partnership.*—From the point of view of the firm, the fact that the limited partnership is subject to the regulatory power of the state is frequently a disadvantage. Moreover it is not open to all forms of industry and enterprise. Only such businesses as the statutes enumerate may be conducted under this form of association. If, as is the case in some states, the law does not include private banking as an occupation expressly permitted to be organized into a limited partnership, a group of people wishing to go into that business in the form of a limited partnership might execute all the instruments, go thru all the forms and follow all the rules required by the statute; however, the association would not be a limited partnership, but a general partnership and the so-called special partner would not escape unlimited personal liability.

8. *Conclusion.*—In continental Europe the limited partnership is used extensively. It has the great merit, from a social standpoint, of placing responsibility on the active managers. Since those who escape liability are not asking for immunity from their

own acts and cannot be said to have misled creditors in choosing their principals any more than the creditors have misled the special partners by extending credit to the concern, this would seem an excellent form of business that merits more extensive adoption in America and England. However, the many causes for dissolution, and chiefly the certain dissolution thru death, prevent the limited partnership from borrowing large sums; its use, therefore, will generally be confined to relatively small concerns and to businesses that require close management and large personal responsibility.

### REVIEW

Could limited partnerships be required to pay a special organization tax?

If a special partner of a limited partnership dies, does the firm cease to exist?

Outline the points to be covered in a limited partnership agreement for the business you are in.

Is there any way in a limited partnership to separate risk and control, i. e., can the managing partners limit their liability?

# CHAPTER V

## SYNDICATES

1. *Syndicates defined.*—A syndicate is a group of persons who form a combination, not to carry on a business continuously, but to transact some business in connection with a specific piece of property. Thus, it may be formed to take an option on a piece of land and to dispose of the option at a profit; or it may be formed to insure to a corporation the sale of a block of securities at a certain price and within a certain time. Perhaps the chief idea in the minds of the members of a syndicate is to close out the transaction quickly and to make a large profit. Both those ideas are summed up in the phrase "to make a killing."

In everyday transactions—those not connected with the sale of corporate securities—the term most frequently used is "deal." We often hear the expression "I have a deal on hand with so and so." When banking houses cooperate in the purchase and sale of securities, the association is popularly known as a "syndicate," tho among the bankers themselves the term "joint account" is growing in favor.[1] The tech-

[1] When a group of bankers, answering a call for bids, nominate a member to submit offers for the benefit of all of them, with the intention of selling the securities thereafter under the terms of an agreement,

nical name of all these arrangements in law is "joint adventure."

2. *History.*—Recently the joint adventure, or the syndicate, has increasingly come into use as a type of business organization. Perhaps this is due to the fact that the financial syndicates of the last forty years have proved so profitable.

The real reason for the growing popularity of the syndicate is the changed methods of doing business. With the rapid growth of transportation and of the means of communication, has come a general appreciation of the advantages of mobility in the movement of large sums of capital. There are now many opportunities to skim off a profit in a quick trade, because advertising has developed the ability to make quick sales. And your clever, astute business man sees that a quick turnover of capital—capital which is perhaps borrowed, or which, as in the case of syndicate underwriting, is only potential—is more lucrative than a long, complex business process.

3. *Legal nature of syndicates.*—Because deals are

the arrangement is technically called a joint account, the constituents are called members, and their interests are known as participations. When, however, a group of bankers thru a manager agree with a corporation to insure to the corporation the sale of its securities to the public at a stipulated price, and within a specified time, and agree that if the sale is not made to the public the syndicate will take the securities, the process is known as underwriting, the group is called a syndicate, its members are termed subscribers, and their interests are known as subscriptions. In this chapter the terms are not strictly within these meanings, the process generally in the mind of the author being the joint account, tho what is said of methods, managing and rights and liabilities of the parties, unless otherwise specified, applies to commercial deals, joint accounts and syndicates. For a discussion of underwriting methods see the Text on "Corporation Finance."

of fairly recent origin, because they have been in the main successful to the extent of satisfying even the most ambitious enterpriser, and because they are generally formed by men of means and of high intelligence, the law of joint adventures is not abundant and the legal relation is not well-defined. Law grows out of litigation, and concerning syndicate ventures litigation has not been abundant. This, as indicated, has been due to their success, but another reason for the absence of litigation is that a syndicate is generally organized by some influential person whose management is autocratic. Let some member of the syndicate doubt the manager's integrity and he may as well at once count himself out of future deals. To incur such a punishment is usually deemed an expensive method of insisting upon fancied rights.

The syndicate, or joint adventure, resembles the partnership. The chief differences are the following: Since the syndicate usually involves merely the investment of money or property, or the assumption of a definite risk, and generally does not require the rendering of personal service, no member may withdraw his interest without the consent of all the other contracting parties. Moreover, upon the death of an adventurer, the adventure need not be closed up; the decedent's capital remains committed to the undertaking, which the survivors carry thru, finally rendering an account of the profits to the decedent's estate. Then, too, on account of its peculiar nature, corporations may become members if the object of the syndi-

cate falls within the general scope of the corporation's charter powers. This fact is in contrast with the familiar principle that corporations cannot enter into ordinary partnership relations.

But the chief difference between the partnership and the syndicate lies in the fact that while in the former a member may not sue the partnership or any of the partners for a sum of money on account of a partnership transaction (the only remedy being to seek an accounting in a court of equity), in the latter the members may sue one another at law for a breach of the contract, or for a share of the profits, or to compel others to make a contribution for advances made by some of the adventurers in excess of their agreed share.

4. *Form of syndicate agreement.*—As in the case of the partnership no specific form of agreement to be used for the syndicate is established; the agreement may be oral or it may be in writing. It is said that syndicates in which the business involved millions of dollars have been arranged over the telephone. Frequently, in the big syndicates including the financial houses of New York, whose purpose is to underwrite the sale of securities, preliminary arrangements are made by telephone and the understanding arrived at is then confirmed by letter. Sometimes the agreement is more formally set forth in a written or printed contract to which the members subscribe.[1]

[1] For a complete syndicate agreement, see Gerstenberg's "Materials of Corporation Finance," pp. 405–409.

5. *Administration of the syndicate.*—Usually the property of a syndicate is managed in the name of one person, who holds it in trust for the other members. Everything concerning the syndicate is then arranged for by this so-called manager. In the syndicate agreements used in ordinary financial transactions a clause like the following is frequently found:

The Syndicate Managers may sell to any subscriber any bonds or temporary certificates held hereunder, and any such subscriber may make any purchase of bonds or temporary certificates from the Syndicate Managers. The Syndicate Managers shall have absolute control over the disposition of all bonds and any temporary certificates held by them hereunder, subject to the provisions hereof. They shall have sole direction and management and entire control of the Syndicate, and shall have exclusive power to determine whether and to what amount or amounts and at what time or times the option of purchase above mentioned shall be exercised. They shall be sole judges, in behalf of the Syndicate, as to the form and terms of said bonds. The enumeration of particular or specific powers in this agreement shall not be considered as in any way limiting or abridging each power and discretion intended to be conferred upon and reserved to the Syndicate Managers, in order to authorize them to do any and all things proper, necessary or expedient, in their discretion, to carry out the purposes of this agreement. The Syndicate Managers shall not be liable for any error of judgment, or for any mistake of law or fact, or for anything except gross negligence or bad faith. Each subscriber nominates and appoints the Syndicate Managers, his agents and attorneys irrevocably until the termination of this agreement, to enter into or execute any and all arrangements or agreements deemed by the Syndicate Managers expedient or necessary to said agreement for the purchase of said bonds by the Syndicate and the issue of the

temporary certificates herein referred to, and to accomplish the objects and purposes of the Syndicate; and each subscriber hereby ratifies and assents to any action of the Syndicate Managers taken under this agreement, and agrees to perform his undertakings herein, from time to time, promptly on the call of the Syndicate Managers, to the full extent of his portion of the entire Syndicate liability.[1]

6. *Members cannot bind the syndicate.*—Unfortunately the legal relationship arising out of a joint adventure is not defined in the common law, and one who examines the cases which relate to the subject will be struck by an apparent confusion in the minds of the courts before whom these agreements have come. Some of this confusion is due to the fact that the agreements are by no means uniformly worded, and that the courts therefore construe each one as it comes before it. It is generally conceded, however, that when an agreement provides that the members are not partners, and when the property is held by the managers who are given authority to control it, no member can bind the syndicate by a contract with a third person. Unlike the case of the partnership, therefore, each member is not a general agent within the scope of the syndicate business. This form of organization, in a word, provides the means of concentrating control.

7. *Rules governing administration of syndicates.*—The syndicate is usually governed by a manager whose powers are practically unlimited. Certain rules, how-

[1] From Syndicate Agreement managed by Speyer and Company, for sale of Republic of Cuba bonds.

ever, are generally laid down in the agreement, or are set forth in a separate document. These rules prescribe the general method of operation of the syndicate. For syndicates formed to underwrite the sale of corporate securities, the Investment Bankers' Association of America has outlined a set of rules the important features of which may be noted.

The prices at which securities shall be sold are stipulated, these prices to be changed only by the consent of a majority of the syndicate members.

When the members of the syndicate help to sell the securities, they are usually given a commission, which is considered part of the expense of the syndicate.

The right of each member to sell securities is restricted to certain territories. This prevents the participants from coming into competition with one another, and also forestalls unnecessary duplication of effort.

The duration of the syndicate is usually agreed to be such a period as is necessary to consummate the venture—i.e., to sell the securities—tho provision is made that if they are not sold within a specified time, e.g., a year, the securities remaining at the expiration of that time shall be divided among the members in proportion to their respective shares in the enterprise.

8. *Liabilities of syndicate members.*—Syndicate agreements usually stipulate that the members shall not be partners, that they shall be liable for the obligations of the syndicate only to the syndicate manager in proportion to the amounts of their subscriptions, and

that the agreement "shall bind and benefit ratably not only the parties to it but their respective successors, survivors, assigns and personal representatives."

As was hinted in a previous section, the law on this subject is somewhat hazy. This much, however, is fairly well settled: When the agreement provides that the participants shall be liable only to the managers, and then only to the extent of their several subscriptions or participations, that provision will be binding on the syndicate and on all persons dealing with the syndicate who have a knowledge of the provisions of the agreement.

One dealing with a syndicate carrying on a joint adventure would apparently be held to a more intimate knowledge of the syndicate agreement than one dealing with a partnership need have of the agreement of the partnership, as to the precise scope of the partnership business.[1]

9. *Forming a syndicate.*—It has already been indicated that the syndicate manager is a very important person. If the manager is a banking house of well established reputation, it would not be far from the truth to say that the manager is the syndicate. Whatever share other members have in it, they enjoy largely because they are in the manager's good graces and he is disposed to let them in on a good thing. In other words, it is probably more often true that the manager chooses the syndicate members, than that the members choose the manager.

[1] "Joint Account Letters and Forms and Some Consideration of the Law of Joint Account," by Hastings Lyon, p. 24.

The usual process is for one banking house to arrange in consultation with the issuing corporation the financial plan according to which the securities are to be issued and to undertake to form a syndicate for the purpose of floating the issue. It is generally known in financial circles that some such plan is in contemplation. The banking houses which are usually associated with the manager expect to participate in the syndicate to be formed, and other houses which like Barkis are "willin'" usually contrive to make this known to the syndicate manager.

In some instances the manager invites all those whom he may wish to associate with himself in the undertaking to participate and asks to what extent they desire to take part. If the issue promises to be popular, the requests are large and have to be scaled down proportionally to meet the amount available for allotment. Such a course often results in disappointment and to avoid this managers often resort to allotment before the syndicate is formed.

In the latter case, each proposed member is asked to participate to the extent named in the letter of invitation, the "syndicate letter" as it is called. If the amount offered appears small in relation to the standing of the house it is usually explained that the amount available for allotment does not permit a larger share.

Each issuing house has its syndicate list and where it makes an offer to any one on the list expects it to be accepted. If participation is declined offense is some-

times for given. Some houses have the rule that if a declination is received no invitations to participate in subsequent syndicates will be issued.

10. *Putting thru a deal.*—Those who plan a deal usually contemplate the purchase of property and the sale of the property. Money has to be raised, or credit obtained, to get the property, and some effort has to be made to sell it; if these efforts are unsuccessful the syndicate must divide what is left among the members, thus closing out the deal. Sometimes property is taken under option only, and the title is transferred before the option expires. Such a transaction generally requires just enough money to bind the option. The syndicate makes its profit with practically no investment. In other agreements, the property is gradually acquired and paid for, and the members contribute the sum needed in proportion to the amount of their participations. The amounts of these contributions are computed by the manager, who issues a "call." Very frequently these calls are given on very short notice, so that even tho the member may not have much money invested at any time he will have to be ready to contribute the entire amount of his participation whenever it is demanded.

The following letters, taken from the Armstrong Report Exhibits, were sent by a manager to a participant of an underwriting syndicate, and show clearly how a transaction is actually put thru, from the time the invitation is accepted until the deal is closed:

J. P. MORGAN AND COMPANY
23 Wall Street

New York, May 3, 1901.

Equitable Life Assurance Society of the United States,
120 Broadway, New York City.

CHICAGO, BURLINGTON AND QUINCY PURCHASE SYNDICATE

*Dear Sirs:*

We have received from you an original of the Chicago, Burlington and Quincy Purchase Syndicate agreement, dated April 25, 1901, signed by you as a subscriber thereto, for $1,500,000. Your subscription is confirmed accordingly, and we hand you, enclosed, a copy of said syndicate agreement for your files.

Yours very truly,
J. P. MORGAN AND COMPANY.

J. P. MORGAN AND COMPANY
23 Wall Street

New York, May 14, 1901.

Equitable Life Assurance Society, New York.

CHICAGO, BURLINGTON AND QUINCY PURCHASE SYNDICATE

*Dear Sirs:*

Referring to the C., B. and Q. purchase syndicate agreement, dated April 25, 1901, to which you are a subscriber for $1,500,000, we now request you to pay us at our office, No. 23 Wall Street, on or before Thursday, May 16, 1901, the sum of $150,000 on account of your said subscription.

Yours very truly,
J. P. MORGAN AND COMPANY,
Syndicate Managers.

J. P. MORGAN AND COMPANY
23 Wall Street

New York, July 19, 1901.

Equitable Life Assurance Society, New York.

CHICAGO, BURLINGTON AND QUINCY PURCHASE SYNDICATE

*Dear Sirs:*

Referring to the C., B. and Q. Purchase Syndicate agreement, dated April 25, 1901, to which you are a subscriber for $1,500,000, we now request you to pay us at our office, No. 23 Wall Street, on or before Monday, July 22, 1901, the sum of $187,500 on account of your said subscription.

In making payment, please present our receipt for your first payment, in order that we may stamp this second payment thereon.

Yours very truly,
J. P. MORGAN AND COMPANY,
Syndicate Managers.

J. P. MORGAN AND COMPANY
23 Wall Street

New York, July 1, 1902.

Equitable Life Assurance Society, New York,

CHICAGO, BURLINGTON AND QUINCY PURCHASE SYNDICATE

*Dear Sirs:*

Referring to our communication of June 26th, we desire to inform you that the syndicate is closed and the account is made up.

The amount of the syndicate is $75,000,000, of which your participation is $1,500,000. You have previously paid us, from time to time, $337,500; the profits on the account amount to $1,850,000; your share of which is $37,000; total amount due you $374,500.

Upon presentation of your syndicate receipt at our office, properly indorsed, we will hand you check to your order for the above amount.

Yours truly,

J. P. MORGAN AND COMPANY.

The letters quoted give some interesting indications of the nature of syndicate operations. It appears that from the syndicate agreement of April 25, 1900, to the final distribution of profits July 1, 1902, a period of more than one year elapsed. This is an unusual duration for a syndicate. Often their affairs are wound up within a month or two months. They also reflect the celerity with which its detailed operations are carried out. Two calls are noted here. In one case a call issued Tuesday asks for a payment of $150,000 on Thursday while in the other the call is issued Friday and the payment is to be made on the following Monday.

The agreement sometimes provides—and this form is perhaps more frequently used in England than in this country—that the manager shall have the right to borrow money on the strength of the underwriting agreement. With such a clause in the contract, the manager would borrow sufficient money from a bank

to acquire the property, and then pledge the property and the credit of the syndicate members, in proportion to their participations, to the bank to insure repayment of the loan. As the property is sold the loan is reduced, and if the loan is not wiped out at the expiration of the stipulated time, the subscribers contribute the amount remaining, in sums usually in proportion to their respective interests in the undertaking. The way the property not disposed of is usually divided among the syndicate members is described in the next section.

11. *Usual methods of dividing liability.*—Let it be assumed that a typical transaction takes place, in which a syndicate of three members buys $1,000,000 worth of bonds, of which A takes $400,000 and B and C $300,000 each. Assume that the members are to try to sell these bonds to their respective clients, and that they succeed in disposing of bonds as follows: A, $500,000; B, $200,000 and C, $100,000. The syndicate is then closed out with $200,000 of bonds on hand. How shall these bonds be distributed?

In most of the old agreements the contract is so worded that bonds sold by any members are deemed sold for the benefit of the syndicate, and not for the benefit of the member himself. In the case that has been assumed, therefore, A would take and pay for 4/10 and B and C each 3/10.

Sometimes the agreement provided that if any

member, instead of selling to outsiders, cares to withdraw his proportionate share he may do so, upon paying his proportion of the expenses of the syndicate and the commission of the manager. He must in such a case agree not to sell or offer the securities for sale during the life of the syndicate. When a member exercises this privilege he either wants the securities for an investment, or to hold them for higher prices. Such withdrawal privileges are not contained in all agreements, and lately there has been an increasing tendency to omit them. If there are no such rights stipulated in the agreement, the subscriber who wants the securities for his own use must purchase them in the same manner as outside purchasers.

Recently more stress has been placed on the ability of a member to help the syndicate to sell its properties. In such agreements allowance is made for the fact that certain members may be more successful in their selling campaigns than the others. A typical provision of this kind is as follows:

> Each member who has sold bonds in excess of the amount of his participation shall have his proportional amount of the unsold bonds reduced by an amount which shall be the same per cent of the unsold bonds as he has sold of the account in excess of his participation. The total of these reductions shall be added to the amounts of those members who have sold less than their participations, in proportion to that percentage of the account by which their sales have fallen short of their participations.

12. *Method of settling a syndicate.*—If the rule stated in the previous section is applied to the set of

facts assumed above, the results given below are obtained, which, for the sake of clearness and brevity, are tabulated:

| | *Amount of participation* | *Amount sold* | *Relation of amount sold to participation* |
|---|---|---|---|
| A | $400,000 | $500,000 | + 10% |
| B | 300,000 | 200,000 | — 10% |
| C | 300,000 | 100,000 | — 20% |

The amounts each member would have to take up, in proportion to the amount of his participation, if the amounts were not increased or decreased on account of the amounts sold, are $80,000, $60,000 and $60,000, respectively. But, according to the agreement, A is to be relieved of 10% of the entire amount unsold, i. e., 10% of $200,000 or $20,000, so that A would be required to take only $80,000 minus $20,000 or $60,000. B and C would take, in addition to their respective shares of $60,000, the amount deducted from A's liability, in proportion to their respective deficiencies. That is, B and C would be required to take the $20,000 deducted from A's share in the ratio of 10 to 20. They would, then, take $6,666 2/3 and $13,333 1/3 respectively.

The results, so far, may be summarized as follows:

A would take $80,000 — $20,000 or $60,000
B would take $60,000 + $6,666 2/3 or $66,666 2/3
C would take $60,000 + $13,333 1/3 or $73,333 1/3

The complete results would then be the following:

| | *Participation* | *Sold* | *Taken up* | *Total sold and taken up* |
|---|---|---|---|---|
| A | $400,000 | $500,000 | $60,000 | $560,000 |
| B | 300,000 | 200,000 | 66,666 2/3 | 266,666 2/3 |
| C | 300,000 | 100,000 | 73,333 1/3 | 173,333 1/3 |
| | | | | $1,000,000 |

It is unnecessary to add that the above rule, and the figures that accompany it, do not state the only methods of dividing responsibility, altho they illustrate the agreement most frequently used.

13. *Rights of syndicate members.*—The rights of syndicate members are set forth in the agreement. They consist chiefly of the right to a share in the dividends, or profits, and of the right to earn commissions by helping dispose of the syndicate property. There is also the withdrawal right, already alluded to. If a syndicate member is an investor and would like to take and hold some of the securities for investment or speculative purposes, he is given the right of withdrawal, i.e., the right to take the securities at cost. He saves the difference between the syndicate's cost price and the selling price. Of course he is entitled to no other profit, and still remains liable for his share of the syndicate expenses.

There seems to be something unreal about rights which are never exercised, and this situation describes some of those which syndicate members possess in principle. The testimony of Mr. Frederick Strauss of the firm of J. & W. Seligman is interesting.

> Success in the formation of a syndicate depends to a great extent on the reputation of the syndicate managers for good judgment, fair dealing and success in conducting previous syndicates. In fact, syndicate operations from start to finish are based on faith in character, ability and experience. No syndicate member ever asks for an accounting from the managers, and none is ever given unasked by the managers to the syndicate participants. The letter announcing the

distribution of profits or the apportionment of losses sometimes states that the syndicate accounts are on file for examination by any syndicate member, and such accounts are carefully prepared and kept among the syndicate managers' records, but for any syndicate member to avail himself of the offer contained in the letter of the managers, would be regarded by the latter as an intentional affront and business relations between the managers and the inquisitive syndicate member would terminate as soon as the examination of the accounts was completed.[1]

14. *Famous deals.*—In the period of riotous speculation following the Restoration, and even as late as the year 1720, England and France saw the creation of many deals, the most important of which was John Law's Mississippi Bubble. Business men would find it interesting to study the eventful career of that famous promoter. After the change in the corporation laws of England, in 1720, syndicates or deals did not come into prominence until about the time of our Civil War. Since then deals have been of common occurrence; in some of them many of our big financiers have amassed their fortunes.

In the seventies there was the famous Fisk-Gould-Drew syndicate in Erie stock; in the same period the clash between this syndicate and Commodore Vanderbilt took place. In 1895 Congress recognized one of the most important syndicates ever organized, that composed of J. P. Morgan and Company and August Belmont and Company. The latter represented the powerful foreign house of Rothschild. As the result of a contract between the government and the

1 "The Modern Underwriting Syndicate." An Address, 1917.

syndicate, the latter agreed to deliver to the government over sixty-five millions of gold; one-half of this amount was to come from Europe. No banker or bank could have carried thru such a deal single-handed. In 1901 there was the famous Hill-Morgan syndicate, which grew out of the threatened railroad war between the Great Northern and the Northern Pacific railroads, controlled by Hill and Morgan respectively.

Shortly after this the same syndicate defended its control of the Northern Pacific against the attacks of an equally notable syndicate, composed of Harriman and the banking house of Kuhn, Loeb and Company. The latter syndicate, by buying up the stock of the railroad, first secretly and then openly, succeeded in getting a majority interest, tho most of their stock was of the preferred issue. Hill threatened to postpone the annual meeting till he could retire the preferred stock under the terms of its issuance. The conflict was ended by throwing all the stock into the Northern Securities Company, which was formed to control the Northern Pacific and the Great Northern.

Perhaps the largest syndicate of bankers ever organized to purchase and float a loan was that formed by J. P. Morgan and Company in 1915 to dispose of the Anglo-French issue of $500,000,000 worth of bonds to be sold in America. The syndicate contained one hundred and seventy-five members.

15. *Syndicate organizers.*—As in the case of the

majority of important business transactions, syndicate dealings usually revolve about one person of more than usual business ability. The elder J. P. Morgan achieved his greatness by early proving his ability to negotiate deals. One of the most interesting figures in American finance of the generation that was in its prime at the turning of the last century was James R. Keene. That brilliant market manipulator seemed to have a superhuman knowledge of market movements. He had little difficulty in persuading men to join his pools when the purpose was to make a quick profit from a strong bull or bear movement.

One of Keene's most interesting pools—tho it proved to be one of his unsuccessful attempts—was the Southern Pacific pool of 1902. The syndicate agreement was dated January 29, 1902. According to the terms, it was to expire April 1, 1903, and it was not to become operative till 200,000 shares of the stock had been acquired. The total holdings of the syndicate, generally acquired on margin, amounted to 244,000 shares. At the time the majority interest of the company, consisting of 750,000 shares, was in the hands of the Union Pacific.

In order to "bull" the market, the pool undertook to compel the road to pay dividends instead of using all its net income to provide betterments. When that process of "boosting" the stock proved impossible, the pool began to collect proxies to contest the Harriman control at the next annual meeting. This at-

tempt, too, proved unsuccessful. Then, two days before the meeting occurred, the pool attempted, without success, to prevent the Union Pacific from voting its 750,000 shares thru the equity courts. Finally Harriman grew impatient of being on the defensive and made a counter attack, using the pool's own appropriate weapons. He secretly transferred 300,000 shares to William Rockefeller, with the understanding that the latter should resell. The market was flooded, Southern Pacific shot downward, and the pool broke up with a loss estimated at $3,000,000.

### REVIEW

What is the origin of the syndicate? To what sort of men does it make its appeal as a form of business organization?

What are the chief differences in the privileges and liabilities of a member of the syndicate and the general partner?

What agreements or stipulations usually appear in a syndicate contract?

An agreement is made between the manager of a large financial house and a railway company to build twenty miles of railway tracks within ten months at $50,000 per mile. Assume that you are the manager of the financial house, and arrange a syndicate for carrying out the plan.

# CHAPTER VI

## BUSINESS TRUSTS

1. *Popular meaning of "trusts."*—With a popular audience trust always means a large combination of industry, to which instinctively a monopolistic tendency is imputed. This is natural enough since when industrial combinations were first widely discussed in the eighties, the two most important combinations—those in oil and sugar—existed in the legal form of trusts. In each case the stockholders of several companies which had previously competed, turned their stock over to trustees who exchanged them for certificates entitling the holders to whatever dividends the trustees collected on the stock. Since the trustees had the title to the stock of the several companies transferred to their own names on the books of the several corporations, they had the right to vote and thus to control the companies. The arrangement was a trust —that is, a device whereby one person known as a trustee holds the legal title to property and manages it for the benefit of one or more persons known as beneficiaries (or *cestuis que trustent*, singular, *cestui que trust*). The word "trust" stuck to monopolies tho later these monopolies gave up the legal [1] organ-

[1] The word "legal" in the Text is not used as the opposite of illegal, but as distinguished from such words as "economic" or "financial."

ization of the trust and resorted to holding companies and other forms of organization.

To use the word trust at the present time for such combinations, is to confuse the form with the substance. So far as this form of organization in the popular use of the term trust ever existed, it represented a secondary not a primary form of business organization. It was a grouping of separate business concerns for united action. With trusts as a method of affecting combinations, we are not at present concerned.

2. *Original trusts.*—The business world is perhaps more familiar with the word trustee than with trust, and it would perhaps be clearer to say that we are concerned here with the function of trustees in the business world. The relationship grows out of a wide variety of incidents which need not be discussed in detail. In general the duties of a trustee are fixed by the conditions of his appointment, and these are duties which may fall to the lot of any man of affairs. In the most familiar form a trustee carries out the purposes of those who create the trust for the benefit of third persons. In some cases the beneficiaries are also the creators of the trust, and it is under such conditions that the trust may become a full-fledged form of business organization. However, circumstances under which the trust is created do not affect the rights, powers and duties of the trustees, tho they determine to whom the trustees are accountable.

3. *History.*—In 1279, Edward I of England by

the Statute of Mortmain, forbade the gift of land to the clergy, because in their hands land was no longer liable to feudal dues. Thereupon the device known as the "use" sprang up. The land was given to a natural person who held it to the use or for the benefit of the clergy. Out of this grew the trust relation.

Since those days the trust has served many useful purposes where it has been expedient to vest the legal title and control in one person or persons and the income in another.

4. *Purposes of trusts.*—Trusts may be created for various purposes, such as holding property in order to give the income to one person during life and the remainder at his death to another; or to protect the principal of an estate against the foolish or incompetent actions of a minor or a spendthrift. But these are private matters and do not come within the scope of this work which is concerned with methods of controlling property committed to business enterprise. Trusts of this kind are found in the so-called mortgages or deeds of trust, car trusts, the so-called Massachusetts trusts and voting trusts.

5. *Legal nature of trust.*—A recent writer has aptly and concisely explained the nature of a trust thus:

> By means of the trust it was possible to give nominal ownership to definite individuals (machinery being devised for replacing these individuals as they died or needed to be removed), while substantial ownership was given to the group. Like the idea of corporateness, the idea of trusteeship contains something fictional. If A, the nominal owner, holds

property in trust for B + C + D as beneficial owners, the ownership of A as against B + C + D is a mere sham. As against strangers, however, A's ownership is real enough in the law: A is not a mere agent for B + C + D; A is the legal owner.[1]

In this form of ownership and management the title and entire control is placed in the trustees; the beneficiaries have a claim against the trustees personally but not against the trust property. In this respect the relation is much like the corporation, for stockholders have an interest in the corporation but no direct interest in the corporate property. The beneficiary has no remedies, legal or equitable, directly against a stranger, but must act thru the trustee.

6. *Liabilities of trustees.*—In the ordinary trust, the trust estate is chargeable with all debts tho third parties make their claim against the trustee personally, and he reimburses himself from the estate. In active trusts where the trustee has an active duty to carry on a business with the trust property, the agreement creating the trust ordinarily sets forth the rights and liabilities of the parties. These agreements ordinarily contain clauses similar to the following:

The Trustees shall have no power to bind the shareholders personally, and the subscribers and their assigns and all persons or corporations extending credit to, contracting with, or having any claim against the Trustees shall look only to the funds and property of the trust for payment under such contract or claim, or for the payment of any debt, damage, judgment, or decree, or for any money that may otherwise become due or payable to them from the

[1] Carr's "Collective Ownership," p. 3.

Trustee, so that neither the Trustees nor the shareholders, present or future, shall be personally liable therefor.

In every written order, contract, or obligation which the Trustees shall give or enter into, it shall be the duty of the Trustees to stipulate that neither the Trustees nor the shareholders shall be held to any personal liability under or by reason of such order, contract or obligation.[1]

The courts are not all agreed on the effect of such a provision, but the federal courts have held that one who deals with a trust estate and knows the terms of the trust, impliedly assents to be bound by them. Moreover, when one deals with a person acting in a trust capacity he is bound to inquire into the terms of the trust.

7. *Liability of beneficiaries.*—In the so-called Massachusetts trust or business trust, title to property is held by trustees, and managed by them, for the benefit of a large group of beneficiaries. The trustees really own the property but account to the beneficiaries for the profits. These beneficiaries change from time to time thru the sale from one person to another of the certificates of beneficial interest. Are the beneficiaries existing at any one time liable personally for the contracts of the trustees? In one of the earliest English cases describing this method of doing business, one of the lord justices described the situation as follows:

In my opinion, what must be shown is that the associations by themselves or by their agents carry on a business.

1 Quoted from "Trust Estates as Business Companies," by John H. Sears.

Now, here, what can be said? That the certificate holders do it by themselves, can, I think, hardly be contended. All the powers which the subscribers of this money had was to attend sometimes at meetings. The only business done at them was to receive and consider a report from the trustees on the condition and affairs of the trust, to appoint auditors to audit the accounts and to elect new trustees to fill up vacancies. It is impossible, in my opinion, to say that the certificate holders are by themselves in any way carrying on any business by reason of what is done at these meetings. Then clause 20 says, that reinvestment must be sanctioned at a meeting of the certificate holders summoned for that purpose. . . . All that is here given to the certificate holders is the power to give such assent as *cestuis que trust* usually given for a change of securities when they are not incapacitated by infancy or otherwise. They meet as *cestuis que trust* to give their assent, not as members of the partnership joining to carry on and control the business of the partnership even if it were a business.[1]

And another lord justice in the same case said that the certificate holders were not liable for contracts made by the trustees.

8. *Deed of trust.*—When a corporation covers all its property with a large mortgage, the mortgage is made out to a trust company which acts as mortgagee for the benefit of the equitable mortgagees, the bondholders. This method has the advantage of requiring but one mortgage, of permitting a transfer of the bondholders' interests without requiring a transfer of the mortgage and of permitting the company to have all its dealings with one person instead of with

[1] Smith vs. Anderson, Sears' "Trust Estates as Business Companies," p. 59.

many, perhaps thousands of persons. The trustee is the legal mortgagee and has the primary right to see that all the mortgagor's covenants are observed and to foreclose the mortgage in case of default.

9. *Car trusts.*—Railroad mortgages cover all the property owned by the company at the time the mortgage is executed and delivered in addition to all property which may subsequently be acquired. Suppose a road wishes to acquire new rolling stock. As soon as the company acquires title the cars become subject to the lien of the previously existing general mortgages under the so-called "after-acquired" clause. A lien placed on the rolling stock to acquire the money necessary to pay the purchase price would therefore be a second lien only. Money obtained in this way with the security of a subordinate lien would demand a relatively high rate of interest. Some way to circumvent the after-acquired clause must be found if the property itself is to be used as security in raising the money needed to purchase it at a fair rate of interest. Consequently it is usual for the car manufacturing company to sell the cars, not to the railroad but to a trust company which pays for them out of the proceeds of equipment trust certificates. These certificates are the obligation of the railroad; they mature serially and are given in consideration of a lease of the cars in which the trustee is the landlord and the railroad the tenant. When all the certificates are paid, the company pays a nominal sum and gets title to the cars. In the meantime the legal title rests in

the trust company and if at any time the railroad is unwilling or unable to pay interest on the certificates or to pay the instalments of principal as they fall due, the trustee may declare the lease broken and regain possession of the cars. Until title finally vests in the railroad, the cars usually bear a plate somewhere on the gear stating, "This car is the property of the —— Trust Company."

10. *Massachusetts trusts.*—Until 1912, the State of Massachusetts forbade corporations to deal in real estate. This occasioned the device known as the Massachusetts trust, an organization of trustees who hold title to property for the benefit of persons organized as a voluntary association, each member of which receives negotiable certificates of beneficial interest. Many large office buildings and hotels in Boston were controlled in this way. The agreement setting up the trust provides in every case an organization simulating that of the corporation. Thus the certificates are given a par value, profits are divided on the basis of this par value and the trustees hold office for a stated period, being replaced by trustees elected by the beneficiaries who cast as many votes as they have units of beneficial interest. The trustees then agree to carry on the business under a trade name, and to organize with a president, treasurer, secretary and other necessary officers.

In addition to the clause set forth in Section 3, above, the articles of agreement usually contain a provision similar to the following:

It is further expressly agreed that in case any Trustee, officer, or shareholder shall at any time for any reason be held to or be under any personal liability as such Trustee, officer or shareholder, not due to his acts in bad faith, then such Trustee, officer, or shareholder, shall be held harmless and indemnified out of the trust estate from and of all loss, cost, damage, or expense by reason of such liability: and, if at any time the trust estate shall be insufficient to provide for such indemnity and to satisfy all liabilities of and claims upon it, then the trust estate shall, in preference and priority over any and all other claims or liens whatsoever, except mortgages, and except as otherwise expressly provided by law, be applied first to the indemnification of the Trustees from any loss, cost, damage or expense in connection with any personal liability which they may be under or have incurred except as aforesaid: next, to the indemnification in the same manner of the officers, and thereafter to the indemnification in like manner of the shareholders.

11. *Duration of business trusts.*—These business trusts are based not on any statutory enactments, but on the common law of trusts. In most states title to real property cannot be held in trust for a period longer than a given number of years after the death of certain persons alive at the time of the creation of the trust.

For this reason it is usual to find the duration of the trust to be fixed for twenty years after the death of the last survivor of twenty or thirty persons named, the selection usually being made from among the young children of the persons most largely interested in the enterprise.

12. *Form of certificate of beneficial interest in a business trust.*—Perhaps a better idea of the true

nature of these trusts can be obtained by studying the following form of trust certificate:

MASSACHUSETTS ELECTRIC COMPANIES

No. . Shares.

Not subject to assessment.

This certifies that ..... is the holder of ..... preferred shares, in the Massachusetts Electric Companies, which he holds subject to an Agreement and Declaration of Trust, dated June 29, 1899, and on file with the Old Colony Trust Company, which is hereby referred to and made a part of this certificate.

The shares in said Massachusetts Electric Companies are divided into two classes, known as preferred and common, and the holders of the preferred shares are entitled to receive semi-annual dividends out of the net earnings of the Companies, at the rate of four per centum per annum, and no more, payable semi-annually, on the first days of January and July in each year, which shall be paid or set apart before any dividends shall be paid or set apart on the common shares.

The dividends on the preferred shares are cumulative, and if, in any period of six months, semi-annual dividends at the rate of four per centum per annum are not paid on said preferred shares, the accrued and unpaid dividends are a charge on the net earnings of the Companies, payable subsequently before any dividends are paid upon the common shares.

In the event of liquidation, the proceeds of liquidation will be first applied to the payment to the holders of preferred shares of the sum of one hundred dollars ($100) per share and any accrued and unpaid dividends thereon; and the balance remaining thereafter will be divided among the holders of common shares in proportion to their holdings.

The holders of preferred and common shares are entitled to equal voting powers.

This certificate will not be valid until countersigned by the Old Colony Trust Company, Transfer Agent, and the American Trust Company, Agent to Register Transfers; and no transfer hereof will be of any effect as regards the Massachusetts Electric Companies until this certificate has been surrendered and the transfer recorded upon their books.

In witness whereof, the Trustees under said Declaration of Trust, herein designated as the Massachusetts Electric Companies have caused their common seal to be hereto affixed, and this certificate to be executed in their name and behalf, by their Treasurer, thereto duly authorized.

Massachusetts Electric Companies.

By ..... Treasurer.

Countersigned:

Old Colony Trust Company, Transfer Agent.

By ..... Assistant Secretary.

By ..... Transfer Clerk.

Countersigned:

American Trust Company, Agent to Register Transfers.

By ..... Assistant Secretary.

(Form of Transfer)

For value received, I hereby sell, assign, transfer and deliver to ..... of the within named shares of the Massachusetts Electric Companies: and I hereby request that said transfer be recorded on the books of the Companies.

Witness my hand, this ..... day of ....., 19..

....., Witness.[1]

13. *Kinds of business trusts.*—When the corporation Income Tax Law of 1909 was passed, the Supreme Court held that the act did not apply to these business trusts. Immediately, this form of organization became popular. It seemed to give all the bene-

[1] Quoted from "Trust Estates as Business Companies," by John H. Sears.

fits of the corporation without its disadvantages. Later the tax laws were amended so as to include business trusts and the advantage disappeared. But even before this the trust had served as a method of organization for many different kinds of enterprises. Indeed, as Mr. John H. Sears points out,[1] Alexander Hamilton's "Merchants' Bank," founded in 1803 was in effect a business trust. It was not a corporation, not a joint stock company, and tho called a limited partnership, was in legal effect a trust. In recent times these trusts have been used largely as security holding companies, especially where the securities held have been those of public utility companies. Some other notable examples are the Mackay Companies and the Great Northern Ore Trust, the certificates of both of which are listed on the New York Stock Exchange.

In England trusts of this kind are frequently used, their genesis being well described in Cushing's "Voting Trusts," as follows:

> In the past, as now, large blocks of American stocks were so held abroad that the voting power was separated from what some would probably call the legal ownership. Thus, of large American issues earlier held in England, it was at one time estimated that probably less than five per cent were registered in the names of the actual owners. As some of these stocks did not then pay dividends, it simply amounted at that time to an abandonment of the right to vote, the successive purchasers not troubling to have the stock properly transferred on the books of the companies. Later, as some of these stocks began to pay dividends, the obvious de-

[1] "Trust Estates as Business Companies," p. 340.

sirability of sending the certificates to this country for registration occasioned much inconvenience. In addition to this circumstance, it had even then been customary to send such American stocks abroad principally in ten share certificates, which, once endorsed in blank, were transferred repeatedly by delivery; but this practice was abandoned in England as the result of a holding that such certificates were not negotiable instruments.

These two factors seem to have led to the adoption by the English of the practice, already known in Holland, by which large blocks of stock were registered in the name of some "administration," association or trust, which in turn issued its certificates (either of its own stock or of beneficial interest in the particular securities held by it) in smaller denominations and these latter served the purpose of local trading. The individuals whose money was invested in these American securities had no power of voting on the stock itself, and often had not even the power of stockholders in a "holding" company.[1]

14. *Voting trusts.*—Voting trusts are devices for placing the voting power attaching to corporate stock in the hands of a group of individuals usually in order to permit such individuals to continue in office the directors and officers who will be best able to carry the corporation thru some difficult period of its existence. The stockholders turn the legal title to their stock over to the trustees who issue in exchange negotiable certificates of beneficial interest. If the stockholders of several competing corporations select the same trustees, thus insuring elimination of competition and the formation of a monopoly, the agreement will be against public policy and will be void.

[1] Pp. 114–116.

But in most states, if the trust is not to be for an unlimited period, if it is intended to carry out a legal purpose and if all the stockholders may join, thus preventing the formation of an exclusive majority, the courts do not hold these agreements void. In New York they are expressly permitted by statute.

Voting trust agreements have been used in railroads, industrial and banking enterprises. Frequently they are used as part of a reorganization plan. The stockholders surrender their stock to trustees who really represent the bondholders and insure a capable and stable management. The trust agreement, when created for such a purpose, is likely to be continued till the new securities of the reorganized company have been placed on a fairly stable income basis.

Thus, it has been provided that the voting trust should, at the latest, be terminated whenever (often after a five-year period or other term) the general mortgage bonds had received four per cent for two years (Central New England); when the first preferred stock had received four per cent for three years (Colorado and Southern), or for two years (St. Louis and San Francisco); when the preferred stock had received four per cent for two years (Mexican National) or five per cent for three years (Northwestern Elevated); or, for an extreme case, when both classes of stock had received five per cent for five consecutive years (Omaha Water).[1]

15. *Trusts within trusts.*—Often the purpose of a voting trust seems to be to continue in the adminis-

[1] Cushing's "Voting Trusts," p. 17.

tration of the company certain well-informed persons whose advice might be lost thru some change in the ownership of a large block of stock. This was true in the case of the International Harvester Company's voting trust agreement.[1] In other cases the trust is used to avoid some provisions of local law. Thus by the agreement of August 19, 1896, practically all of the stock of the Oregon Railroad and Navigation Companies was deposited with the Central Trust Company of New York and provision was made that the certificates of beneficial interest issued by that trust company might be deposited with the Old Colony Trust Company of Boston or the Deutsche Treuhand-Gesellschaft of Berlin in exchange for certificates of beneficial interest issued by those institutions.

16. *Voting trusts and the railroads.*—Cushing [2] has shown that voting trusts have been used in almost all the large American railroads at some time in aid of some piece of financing. The following account of the use of the voting trust under the direction of a Federal Court, illustrates another application of this device:

In accordance with the decree, of October 17, 1914, of the United States District Court for the Southern District of New York, dissolving the New Haven system, three sets of voting trustees were created, each consisting of five members, who also were made "officers of this court for the pur-

1 For complete form of agreement, see Report of Bureau of Corporations on the International Harvester Company.

2 "Voting Trusts," Chapter I.

pose of carrying this decree into effect." To ex-Judge Walter C. Noyes and associates was transferred the entire capital stock of the Connecticut Company, then owned by the New England Navigation Company; to Rathbone Gardner and associates was retransferred the entire capital stock of the Rhode Island Company, owned by the New Haven itself, and certain shares and bonds, owned by the New England Navigation Company, of the Providence and Danielson Railway Company and of the Sea View Railroad Company; and ex-Judge Marcus P. Knowlton and associates took title both to certain shares, then owned by the New Haven, of sixteen companies leased to the Boston and Maine Railroad Company, and also to the entire common stock and all but about 28,000 shares of the preferred stock of the Boston Railroad Holding Company, which in turn owned the controlling stock interest in the Boston and Maine Railroad Company. The trustees in each instance have all the rights of owners, for varying terms which may extend over a period of about five years, subject only to certain directions as to the ultimate sale of the securities held by them, and subject also to detailed provisions of the decree and further orders of the court. They are furthermore authorized to issue, with respect to the property held by them, negotiable certificates of beneficial interest therein. In no other instance has there been an establishment, in a single transaction, of voting trusts of such significance.

## REVIEW

If a trust agreement provides for the gift of 20 shares of stock from a father to his son; the stock to be held in trust by a lawyer for the son until he becomes of age, after which time the property is to go to him absolutely; who would have the right to vote the above-mentioned stock?

What is the meaning of the term "trust" as a form of business organization?

Discuss the liabilities of trustees and beneficiaries of business trusts.

Of what advantage is the "trust" formed to act as the mort-

gagee for a large corporation to the directors of the corporation? To the bondholders?

What are the purposes of car trusts? of equipment trusts? of voting trusts?

# CHAPTER VII

## CORPORATIONS AS BUSINESS UNITS

1. *History.*—The corporation like most other forms of business organization takes its rise in Roman times. Probably the earliest form is that of the *Collegium* or college of priests. This body had many of the rights and privileges which the law gives to the modern corporation. The *Collegium* could hold property; it could sue and be sued; the rights of the corporate body were separate from those of individual members; it existed in perpetuity, and it was autonomous. Besides the *Collegium*, other Roman organizations such as municipalities, official societies engaged in state administration, military groups and trade societies took on corporate form.

In medieval times something akin to the Roman collegia appears in the municipal and guild organizations which were often closely related. Like the non-stock corporations of the present day, they embodied the idea of the group working as a whole thru chosen representatives, and so exhibited one of the chief characteristics of a corporation from the legal standpoint.

Tho the gilds are spoken of as trade and industrial corporations and were intimately concerned with business affairs it would be a mistake to assume that they

were like the present day corporations—business units operating in any given trade or industry for the joint profit of those who composed them. If you can imagine a voluntary association of retailers or manufacturers in any given line, clothed not only with the desire but full legal authority to regulate the business practices of its members, you have a much closer analogy to the real nature of the gild. It can be understood, too, how under such circumstances, the gilds became so autocratic in their proceedings that as time went on they became a hindrance rather than a help to progress.

At a later period the regulated company, such as The Plymouth Company, familiar from our school histories, the Hudson Bay Company and the East India Company, became a dominant factor in British trade, particularly in foreign trade. Chartered by the government, granted special privileges by their charters, these organizations were fore-runners of modern corporations. In some instances, the trading company was hardly a company at all as we understand it. It consisted of a grant of the right to carry on a certain kind of business in a certain place conferred upon a group of persons. Any member of the group or a number of members jointly might exercise the right, and only those who participated in the particular venture would be entitled to its profits. This was a frequent form of the trading company.

Other companies conducted their operations as a unit and all the associates shared in the common profit.

They became in effect and often in name joint stock companies and in the early part of the last century this was the common form of organization for larger business units in Great Britain.

In the American colonies before the Revolution, corporations were mostly educational, religious or military. They had not been introduced into business affairs. The company as it was then known in the mother country smacked of exclusive privilege and carried the idea of a monopoly granted by the Crown. It was not until the beginning of the 19th century, with the growth of manufactures brought about by the Napoleonic wars and a consequent rise of an investing class, that the corporation really began to make strides. In 1800 it is estimated that there were not over 100 corporations and these mostly in Massachusetts. Between 1800 and 1815 many manufacturing companies and turnpike companies were incorporated and between the latter year and 1835 a large number of canal and railway companies. Within this period too, banking institutions spread rapidly over the country so that the corporate form of organization became thoroly established.

While New York, in 1811, was the first state to provide for incorporation under general laws for business purposes, it was not until about the middle of the last century that the states in general made provision for it. At the same time the principle of limited liability was generally recognized. This principle was not adopted in England until 1855 when Parliament

passed a statute providing that only such companies which announce that their stockholders' liability is limited shall escape the common-law rule that stockholders shall be liable as partners. This is usually done by the use of the abbreviation "Ltd." after the name of the company.

2. *Corporations in modern business.*—Of the part that corporations play in the business life of today, something has already been said. From the small beginnings above noted they have come to the place of honor in modern business organization.

Without considering the corporations already in existence, the annual output of new companies is enormous. The *Journal of Commerce* in its Annual Review of 1918 notes the fact that in that year the "papers filed in the principal states for new companies with a capital of $100,000 or over involved only $2,339,749,600," and comments on the falling off from the previous year when they amounted to over $4,608,895,500. The year 1917 was one of extremely active business operations while in the following year the necessities of government finance absorbed a large share of the capital available for investment.

The figures give no clue to the number of new companies and, of course, they ignore entirely the vast number of small corporations which are created every year. It is worth while to recall that such small corporations are after all the most frequent, as an analysis of the charters granted by any of our states will readily show. The following table gives such an

analysis of charters granted in Massachusetts in 1915.

NUMBER OF BUSINESS INCORPORATIONS IN MASSACHUSETTS BY SPECIFIED GROUPS FOR THE YEAR ENDING NOVEMBER 30, 1915

| Group | Number | Per Cent | Total Amount of Incorporation | Per Cent |
|---|---|---|---|---|
| $1,000 and under $5,000 | 210 | 9.84 | $379,029 | .33 |
| 5,000 " " 10,000 | 267 | 12.51 | 1,413,401 | 1.21 |
| 10,000 " " 20,000 | 922 | 43.22 | 9,688,000 | 8.31 |
| 20,000 " " 30,000 | 131 | 6.14 | 2,978,700 | 2.55 |
| 30,000 " " 50,000 | 74 | 3.47 | 2,458,500 | 2.11 |
| 50,000 " " 75,000 | 252 | 11.81 | 12,776,000 | 10.96 |
| 75,000 " " 100,000 | 43 | 2.01 | 3,530,509 | 3.03 |
| 100,000 " " 500,000 | 196 | 9.18 | 30,187,500 | 25.89 |
| 500,000 " " 1,000,000 | 22 | 1.03 | 13,150,000 | 11.28 |
| 1,000,000 and over | 17 | .79 | 40,020,000 | 34.33 |
| | 2134 | 100.00 | $116,581,639 | 100.00 |

Nearly two-thirds of the corporations here noted had a capital of no more than $20,000 and only a little more than one-eighth of them had a capital of $100,000 or more. These smaller corporations made, of course, a comparatively small contribution to corporate capital. But the great frequency in number of what must be designated as small corporations is a fact often overlooked, which this table sets forth in most emphatic terms.

3. *Corporations assemble large capital.*—It is frequently stated that men incorporate chiefly for the purpose of assembling a larger capital than could be gathered by individuals or partnerships. Capital it is said is often needed in such large amounts that it

can only be obtained thru the contributions of numbers of people.

When we look at such organizations as the United States Steel Corporation with 141,000 stockholders and a capitalization of $868,000,000 or the American Telephone and Telegraph Company which has a capitalization of $435,000,000 and 87,000 stockholders, we are impressed by the fact that the corporate form is needed for such vast enterprises. But when we consider the small Massachusetts corporations for which figures have been given, it would seem that the need of large capital was not the primary motive for the larger number of corporations. We are disposed to minimize the economic advantage of this form of business and give undue weight to its legal advantages in estimating the motives which prompt the formation of corporations.

Yet perhaps the conclusion is a trifle hasty. Large and small are after all purely relative terms. It may be true that many individuals and many partnerships can command far greater capital than these small corporations require, but that is not equivalent to saying that the men who form them can do so. To them the capital required for these smaller enterprises may indeed be large and they can secure control of it for the desired purpose thru no other method than the device of incorporation.

4. *Turning a going business into a corporation.*— Potent as the economic motive still is, it is not, as has already been noted, the sole reason for the present day

popularity of the corporation. That the favor with which it is regarded rests in large part upon the continuity of its operations, the limited liability which it entails and the flexible character of its organization is amply evidenced by the frequency with which existing concerns are transformed into corporations often without increase of capital. The following cases are typical.

A ladies' cloak and suit house in an interior city got into difficulties. There were two partners in the business. One partner sued the other for mismanagement of funds and the other promptly retaliated with a counter charge of neglect and indifference to the business. The suit was settled out of court and the partnership dissolved. One of the partners who desired to continue in the same business found a man who was willing to invest $8,000 in it on the stipulation that the business be incorporated and that his investment be limited to that amount. This stipulation was agreed to and the business was launched as a corporation.

In another instance a real estate operator bought a large tract of land, laid out part of it in building lots and sold them as sites for suburban homes. He amassed so much money in such a short space of time that he desired to protect himself in case, as the brokers say, the bottom should drop out of the market. So he incorporated the business, kept the controlling interest for himself and in this way protected what he

termed his "private fortune." In other words, he limited his liability.

A partner in a mill and supply house died and left his interest in the business to his four sons. The sons thought that if a partnership were formed between them and the remaining partner, the management of the business would become unwieldy. The remaining partner showing a willingness to dispose of his interest, the sons of the deceased partner bought it in and incorporated the business. One son became the president of the company and its active head, a second son was made secretary and the two remaining sons took no part in the running of the business but still remained stockholders in it.

Some years ago before corporations were as frequent as today, the owner of a factory in a large eastern city surprised his business friends by changing his business from a partnership to a corporation. On being pressed for a reason he gave the explanation that a corporation provided for a continuity of business after the death of the owner and at the same time safeguarded the rights of heirs, in this case a wife and one son, better than any other form of business organization. The owner of the business went on to explain that if he died leaving his business in its original form to his wife, it would have to be "settled up." In the corporate form the business at his death would proceed in the usual way, and his interest in it would pass to his wife. As the man was comparatively a

young man, his friends were disposed to think his reasoning rather fanciful but within two years after incorporation the former owner died. It was then seen that he had wisely protected the interests of his wife and child.

5. *Government business corporations.*—One of the most interesting developments in the history of corporations has been the recent intrusion of stock corporations in the conduct of government affairs. Political discussion before the war was more or less familiar with the assertion that government was a business proposition and ought to be conducted on business principles. After the war broke out this phrase was heard still more frequently; it acquired a new meaning; and in a limited sense it became a reality.

There are, it is true, some analogies between peacetime government administration and business, but they are not very close, and they run counter to governing principles of government administration. Business is a somewhat elusive term which lacks clear definition in the minds of those who use it, but it generally implies a series of transactions all bent to the common end of making a profit. The fundamental principle is coordination.

Now the fundamental principle of government administration has been that receipts and expenditures shall be kept rigorously apart. This has been due in part to the fact that ordinarily in government affairs receipts and expenditures were not in fact closely re-

lated. Receipts did not grow out of expenditures, nor were expenditures, as in private business, measured by receipts. Accounting systems of immemorial vogue sharpened this distinction. All receipts must flow into the treasury, and no money can be drawn from the treasury except in pursuance of law.

This scheme had its difficulties, but it worked well enough so long as the Government was chiefly a consumer of goods and services and only in a limited sense (post office) a producer of them. But war has made the Government a producer on a large scale. Part of its production has indeed been for its own use, but part of it has involved the public at large.

Without a complete change in the way of conducting government business, the Government could not, for example, manage the railroads directly. It has, therefore, wisely decided to do so indirectly thru the existing corporate agencies that had hitherto managed the railroads. It is safe to say that the Government could not have built the Panama Canal so expeditiously had it not been for the Panama Railroad. Reference is not made to any technical aid which the railroad gave, but of its place in the business organization of construction. Tho the United States was the chief, almost the only, stockholder in the road, the Railroad was managed by a corporation distinct in law from the Government. The corporation had the utmost freedom of action, which was denied the Isthmian Canal Commission as such. It could and did do many things which the Commission was not empowered to

do, or at least, not empowered to do in the most effective and expeditious way.

The experience of the Government in Panama has been largely utilized in carrying out war policies. In many fields, the Government found it expedient to work thru corporations authorized by Act of Congress or founded under state law. Of these the most conspicuous perhaps is the Emergency Fleet Corporation. But it does not stand alone. Other government corporations which the war brought forth were the War Finance Corporation, United States Grain Corporation, the Alien Property Corporation and the United States Housing Corporation.

6. *Public, quasi-public and private corporations.*— One classification of corporations considers them from the standpoint of their relation to the state. Public corporations are subdivisions of the state with fixed territorial boundaries. They may or may not have delegated to them certain of the attributes of sovereignty. Examples of public corporations are a city, a county, a road district.

Quasi-public corporations or public service corporations are those which possess a franchise to use public property for a public purpose, but for private gain. A railroad company, a gas company, or an electric light and power company illustrates this class.

Private corporations are corporations which are formed for private purposes and for private gain. The ordinary manufacturing or trading company is a private corporation.

7. *Investors' classification of corporations*—The investor is primarily interested in earnings of corporations, and he therefore classifies corporations in such a way that all the members of a given class can be fairly well compared with one another in respect to the stability of their earnings. For this reason the investor speaks of public utilities, railroads, industrials and mining corporations.

Public utilities include urban, suburban and interurban street railways, electric lighting and power companies, gas companies, water companies and telephone and telegraph companies. The railroads include the steam railroads of the country, tho in the process of electrification it has become difficult to draw a line between branch roads and what have heretofore been designated as interurbans.

The industrials include all the manufacturing and trading companies such as the United States Steel Corporation, Westinghouse Electric and Manufacturing Company, American Car and Foundry Company, American International Corporation, Canadian Car and Foundry Company, Limited, the Steel Company of Canada, Limited, etc.

In the class with mining companies are ordinarily included all corporations whose purpose is to extract raw materials from the earth, such as timbering and lumbering corporations.

Public utilities are quasi-public corporations which usually have a monopoly because of their special franchises and because of the immense investment in their

properties and plants. Their earnings, therefore, are more stable than those of the industrials and mining corporations. Further discussion of these companies will be found in the Text on Investment.

## REVIEW

When were the earliest corporations formed? When were corporations first formed for "business" purposes?

Give three reasons why it might be advisable to turn a going business into a corporation.

Define public, quasi-public and private corporations.

From the investor's viewpoint, under what form of corporation would you classify the "Kirby Lumber Company"; "Chicago Dentists, Incorporated"; "Buffalo Light, Heat and Power Company"?

# CHAPTER VIII

## GENERAL ASPECTS OF CORPORATIONS

1. *Nature of corporations.*—Despite the fact that corporations are so universally utilized as business organizations, there is still considerable confusion in the minds of legal authorities as to the exact nature of a corporation. Is a corporation an artificial person? Is it a group of persons with certain powers? Discussions regarding corporations have grown out of the attempts of jurists to make their decisions conform to some self-sufficient definition of the word "corporation." Here is an example of the difficulties with which courts have had to grapple. Three men, A, B and C are in partnership and sell out their business to X agreeing not to go into business again within a certain territory. They immediately incorporate the ABC Company. If the court starts out with the time-honored definition that a corporation is an artificial being, separate and distinct from the persons who constitute it, and if X applies to have the corporation restrained from continuing business, the court, it would seem, would have to deny the application since the corporation is a distinct person and in no way a party to the previous contract. Indeed, in a case involving just such facts an American court did reach

this conclusion. That this decision was iniquitous will at once be apparent to the sense of justice of every business man. Aside from any definitions, the case is analogous to the plea of the criminal that it was not he but his gun that killed the victim. Here three men use an instrument, the corporation, to avoid the obligation of their contract. Obviously in these days we have ceased to permit the ends of justice to be thwarted by fictions that may have been useful in times past. The modern jurist must abandon the whole question of formal and precise definition. The corporation is a group of persons endowed by the state with certain rights. These rights may be enumerated and described, but a wholesome proviso must always be made that no enumeration and no description of rights can be so rigid as to be used at any time as a defense of private or public offenses.

The corporation involves nothing more complicated than a contract—a contract between the state and the individuals composing the corporation. It will be remembered by the student of American history that Daniel Webster in one of his early legal victories succeeded in convincing the United States Supreme Court that the corporate contract came within the provision of the Federal Constitution which prohibits states from avoiding the obligation of contract. A number of persons separating themselves from the corporation of Dartmouth College were given certain privileges by the state which infringed the rights of

the old corporation obtained thru a charter from the crown of England. The court held that the State of New Hampshire was the successor of the crown and succeeded to the latter's obligations; that the new corporation was in fact a new contract avoiding in part the old contract with the established college.

When the full effect of this decision became understood the states immediately took steps to protect themselves. The so-called police power of the state —the power which transcends even the constitution in permitting the state to protect the health, morals and welfare of the people—had not been recognized in law. Hence it seemed possible for the state to make a contract today that would be so injurious in the changed circumstances of another generation as to be almost intolerable. Thereupon the states placed a proviso in their constitutions that all charters thereafter granted should be subject to alteration, amendment or repeal at any time by the state. Thus, if the state does amend or repeal a charter, it does not avoid any of its obligations. The full effect of this doctrine should be comprehended by every business man. A case in point will serve to bring out this effect.

A corporation was formed in the State of New York to carry on a dental business, to hire offices and engage the services of licensed dentists. Thousands of dollars were invested in equipment and advertising. A law was then passed that none but duly licensed dentists could advertise to practise dentistry. This was construed by the courts to apply to corporations

and to prevent corporations from advertising since they could not take the examinations and therefore could not get the prescribed license. But, argued the directors, how about our charter which gives us specifically the right to do exactly what we are doing? The court disposed of this argument by saying that if the law did in effect repeal the corporation's charter the law merely exercised a privilege of the state vouchsafed to the state by every corporate charter, thru the constitutional provision above mentioned. Thus has been lost much valuable good-will in dental, medical and legal corporations.

2. *Corporate powers.*—The reader will object that to show such leniency toward one party to a contract is both unfair and illogical. The state enters into a contract with certain people, yet it may do as it pleases with the contract, may even repudiate any or all provisions. But allowances must be made for the fact that one of the parties is the state, without whose power all contracts would be hollow words. The contract of the state is, in effect, that the persons conducting the corporation shall have certain rights and privileges; that these rights and privileges shall be protected against third persons, and that in collateral matters arising between the state and the corporations these rights and privileges shall be recognized as a basis for negotiation.

These rights and powers may be divided into three classes: implied, express and incidental.

3. *Implied powers.*—The implied powers of a cor-

poration are those powers which every corporation has by virtue of its corporate existence. It is not necessary that they should be expressly stated in the corporate charter. Among them is the power to sue and be sued in the corporate name. Partnerships, it will be recalled, sue and are sued in the names of the individual partners. A corporation has always the right to have a corporate seal, which follows as a natural incident of the right to use a distinct corporate name. More important, however, is the so-called right of continuous succession. By virtue of this power the members may exchange their interest in the corporation without dissolving it, nor is the corporation dissolved by the death of a member.

Right here it is well to point out an important difference between the partnership and the corporation. In the partnership each member is a general agent of the business, and this is the reason why partnerships are dissolved when a partner dies. The survivors should not be compelled to accept the decedent's heirs as their general agents. In the corporation, however, each member is not a general agent. The general agents are the elected directors acting, not separately, but as a unit. Continuous succession, therefore, is possible and not injurious, since the new members of a corporation cannot deal with third persons on behalf of the corporation but can merely help to elect the directors.

Another implied power is the power to hold such property as is necessary to carry out the express pur-

pose of the corporation. In England this includes the right to hold stock in other companies. In this country the power is implied in insurance companies and other financial institutions that could not find adequate means of investing their funds if they were not permitted to hold stock of other companies. For the ordinary corporation the power to hold stocks is an express power that must be claimed in the corporate charter. In a few states special rules prohibit corporations from holding real estate. Finally the corporation has general power to make necessary contracts in the exercise of its express powers.

4. *Express powers of corporations.*—The charter which the corporation obtains from the state confers the right to conduct a certain kind or kinds of business. Thus the corporation may be given the right to run a railroad, to build locomotives, to buy and sell general merchandise and the like. The specific powers thus conferred are termed the express powers of the corporation.

Many of the early charters granted by special acts contained very broad powers. The classic example of this is the Manhattan Company of New York. In his "History of the Bank of New York" Mr. Domett tells the story of its inception as follows:

> The Bank of New York had now been in existence for fifteen years without a rival. It had obtained its charter with great difficulty, and those interested in its success could not be expected to look with complacency upon any attempt to establish an institution to compete with it. Neither did the public desire any additional banking facilities. But sud-

denly and unexpectedly a formidable corporation made its appearance as a bank of deposit and issue in New York. It was the result of the craft and sagacity of Aaron Burr. A petition was presented to the Legislature in the spring of 1799, asking for a charter for a company with a capital of two millions of dollars for the purpose of introducing pure water into the city of New York. As the entire capital might not be required, a clause in the bill provided that the surplus capital might be "employed in the purchase of public or other stocks, or in any other moneyed transactions or operations not inconsistent with the laws and constitution of the State of New York." In these words the real purpose of the scheme was concealed.

The prevalence of the yellow fever during the previous summer had created an alarm which made the passage of a bill to improve the sanitary condition of New York an easy matter. Toward the end of the session the bill incorporating the Manhattan Company was accordingly passed by the Legislature, and passed without a suspicion on the part of the majority of those who voted for it that it contained a grant of banking privileges. But the real purpose of the scheme was soon made manifest. The discovery created great excitement and indignation. It was charged that the Legislature had been cheated so as to enable Burr and his friends to control a majority of the stock of the company and use its capital for their own purposes.

The plans of the persons interested were speedily carried out, and notice was given that the banking operations of the company would commence in September with a capital of $500,000.

This is by no means an isolated case. In 1825, Massachusetts, for instance, chartered the Fall River Iron Works, which was empowered to engage in iron and steel manufacturing and cotton manufacturing, altho the former business was never attempted. The combination of transportation and banking under one

charter was not infrequent. When Maryland in 1814 chartered the Susquehanna Banking and Branch Company, it gave it power to employ any of its funds in the banking business. Similarly, The Delaware, Hudson Canal Company in New York acquired in 1824 the right to exercise banking power for a period of 20 years. In the same year, the Morris Canal and Banking Company was chartered in New Jersey and authorized to conduct banking for a term of 31 years. Connecticut in 1832 chartered the Quinebaug Bank as an adjunct to the Boston, Norwich and New London Railroad. These are only a few instances of a situation which was very frequent. A reminiscence of this period is found today in the Georgia Railroad and Banking Company still in existence, tho modern methods have been adopted by turning over the banking function to a separate corporation, the Georgia Railroad Bank, of which the railroad company owns the stock.

While such broad grants are not so prevalent as in former days, it remains generally true that except for enterprises which must be chartered under special laws, any number of special lines can, in most states, be carried on under suitable general charters.

But in a few states like Pennsylvania, the express powers are restricted to one general line. In many jurisdictions, ordinary business corporations are not permitted to include any and every power that comes into the mind of the projectors. Thus in New York, corporations cannot engage in legal work. Corpora-

tions doing a banking business or a so-called public service business, such as electric lighting and railway transportation, are compelled to incorporate under special statutes that provide special methods of regulation by the state.

It may be fairly said that in Canada also, the express powers granted by charter or letters patent are usually correlated, tho it is at the discretion of the official designated by the various Companies Acts to grant letters patent, to grant a charter for any of the purposes or objects (with certain exceptions) to which the legislative authority of the Parliament of Canada or the particular provincial legislature extends. Accordingly the applicants for charter powers must comply with the prevailing practice of the Department of the Secretary of State for Canada or of the Provincial Secretary. The annual reports of the Secretary of State bear witness to the very wide diversity of powers which certain companies have been authorized to exercise. Thus there is under Canadian practice no reason why a company authorized to manufacture sewing machines should not be authorized to manufacture bicycles, automobiles and typewriters. Among the certain exceptions above noted, to which the discretion of the Secretary of State does not apply are, for instance, banks and insurance companies which are incorporated by special statute.

A company, it must not be forgotten, has only such powers as are expressly conferred upon it, and such incidental powers as may reasonably be inferred from

those powers. Incorporators should therefore be most careful to define in their application in considerable detail the primary objects and purposes for which incorporation is sought, and also such subsidiary and ancillary powers as are not given by the Companies Act, either in express terms or by reasonable implication. The reader will find it of interest to refer, in the Canadian papers, to the "Notices of Incorporation" of companies chartered from time to time by Dominion or provincial authority, and to obtain an idea of how carefully (and at times how carelessly) the objects are expressed.

As to Canadian companies it may be said further that the Department of the Secretary of State at Ottawa has issued a booklet of instructions and suggestions for use by intending incorporators. The statement of objects, we are told, should be clear and concise and should not embody powers which are already embodied in the act under which the company is to be incorporated. For instance, the right to acquire land for the purposes of the company, to mortgage assets and to issue debentures is given by the act, and should not and need not be asked for in the application—unless it is intended to vest the borrowing power permanently in the directors and thus exclude the necessity of having a by-law for this purpose approved by the shareholders, as required by the act. Where the act contains no express provisions on the subject, the power sought should not be left

to inference or implication, but should be expressly stated in the incorporating instrument.

When the courts come to construe object clauses they lean toward distinguishing (at least under English and Canadian practice) the primary or express from the subsidiary objects, the latter being deemed to be limited and controlled by the former. Consequently a company could not carry on a subsidiary business if it had ceased to carry on the principal business for which it was chartered. This defect may be to some extent overcome by inserting in the objects clauses a clause providing that the company can carry on any one or more of the objects, powers or purposes, without regard to the others; and such a clause cannot be made too explicit.

5. *Incidental powers.*—The incidental powers include those privileges reasonably necessary to carry out the express and implied powers. For example, suppose a company had express power to conduct a leather business. Incidentally it would have the right to engage in the lumber business, since to sell the lumber left after the tanning bark had been stripped from trees would be an ordinarily prudent method of making the best of property the company had to acquire. Unless specifically prohibited by law every company has an implied power to borrow money. It therefore has the incidental power of mortgaging its property to secure the loan.

The various Canadian Companies Acts (there is a

Dominion act and a local or provincial act in each province) have provisions which may be generalized by saying that companies incorporated under the particular acts are vested with all the powers and privileges and immunities, requisite or incidental to the carrying on of their undertakings—that is, over and above those powers specially conferred by the general act or by the special act or letters patent. In a word, without it being necessarily so stated in the general or special act or the letters patent, a company may acquire, alienate and possess property, sue and be sued, contract, incur obligations and bind others in its favor. A company is not like an individual; it is created with certain definite powers; these, and such powers as may fairly be regarded as incidental or consequential upon those things which the legislature has authorized, it alone may exercise. This leads us naturally to our next paragraph, a consideration of acts *ultra vires* (beyond the power) of the company.

6. *Ultra vires contracts.*—When a corporation makes a contract that is beyond its express, implied and incidental powers the contract is said to be *ultra vires.* The state may intervene and go so far as to dissolve the corporation. Moreover, the contract is generally unenforcible, especially if it has not yet been acted upon by either party. It is very important, therefore, in cases where a corporation may wish to extend its business in the future, that the charter confer broad privileges and that whoever draws the

contract use his imagination to cover every conceivable line of the business that the company is likely to care to undertake. The charter may indeed be expanded later by amendment; but such a procedure takes time and may cause trouble and, in the case of large companies with many stockholders, may involve an expense which is by no means negligible.

An *ultra vires* act cannot be validated by even the unanimous consent of the shareholders, or by a judgment rendered against the company by consent. If it were otherwise, this creature of the legislature, the company, would acquire from its own shareholders or from the courts the benefit of acts, which by its author, were denied it. A shareholder can sue in his own name alone, to prevent a company either commencing or continuing something which is beyond the company's powers.

7. *Corporations are persons, but not citizens.*—A corporation is generally considered as a person and entitled to all the privileges and immunities conferred by the Federal and state constitutions guaranteeing to every person the rights of life, liberty and property. These cannot be revoked except by due process of law. For a few exceptional purposes a corporation is considered a citizen. For instance, a corporation is entitled to go into the Federal courts if it desires to sue a citizen of another state. But corporations are generally not considered to be citizens. They are not citizens under that provision of the United States Constitution which says that "the citizens of each

state shall be entitled to all the privileges and immunities of citizens in the several states."

8. *Classification of corporations.*—Corporations may be classified in three groups: domestic, foreign and alien. The first group depends on the sovereign to whom the corporation primarily owes allegiance. A corporation is considered domestic only within the state in which the corporation is formed. In other states it is considered a foreign corporation. Corporations organized outside the country are considered alien corporations. They generally have the rights of aliens under the law.

9. *Foreign corporations.*—It is possible for a state to prevent a foreign corporation from doing business inside its boundaries, but such a provision cannot be construed to prevent the corporation from doing business from its home state into any other state of the Union since transactions between the states are considered interstate commerce, over which Congress has exclusive jurisdiction.

In Canada, a Dominion company may do business in any province, tho it may be taxed by the province. It is not regarded as a foreign company, nor can it be prevented from doing business because it does not pay the tax. A provincial company is regarded in other provinces, however, as foreign, and can engage in business in a province other than the province of its origin, only upon permission or license to do so. It may do business from its home province into

another province, but cannot go and establish itself there without license.

Ordinarily, before a corporation may do business within a state or province, it must file certain papers—generally a copy of the certificate of incorporation and a statement designating the place where the principal office inside the state is to be kept, and also some person upon whom service of judicial and other processes may be made. In many states, foreign corporations are required to consent to the appointment of some public official as the person to receive service of processes in the event that the agent designated by the corporation cannot be found. Foreign corporations are also, ordinarily, required to pay a tax which is imposed on the corporation in proportion to the amount of capital employed within the state. If all of the business of the foreign corporation is interstate business and none of it is intrastate, this license tax cannot be collected since it is a burden upon interstate commerce.

10. *General and special franchises.*—Every corporation has a franchise, known as a general franchise. This franchise is the corporation's contract with the state containing the privilege granted by the state to exist as a separate entity with all the rights and immunities of a person within the state.

Quasi-public corporations have in addition a special franchise conferring the right to use public property. General franchises can be multiplied indefi-

nitely. Thus everybody can be given a franchise to vote for public officers, and an indefinite number of corporations can be formed. But special franchises are necessarily limited. It would be impossible for more than, say, a dozen companies to use the tracks laid in a city street, and it has been found quite impracticable to give the franchise to more than one or two companies to lay pipes under city streets.

11. *De jure and de facto corporations.*—A corporation is a creature of the state. It must accordingly be formed as the state prescribes. When a number of individuals undertake to form a corporation, if they comply with all the provisions of the law they have what is known as a *de jure* corporation—that is, a corporation in law. If they do not succeed in complying with all the provisions of the law, they may still have a corporation which will be immune from attack by everybody except the state. To show in the latter case that such a *de facto* corporation or corporation in fact exists, the incorporators will have to prove (1) that there was a valid law under which the corporation could have been formed; (2) that there was a bona fide attempt to comply with the provisions of this law; and (3) that there has been a use of corporate powers, that is, that the individuals have assumed that they have had a corporation and have acted accordingly.

The following instance illustrates this condition: The law provides that three citizens, all of full age,

may form a corporation. A promoter names two[1] persons who with himself are to be the incorporators. It is subsequently discovered that one of the incorporators was not of age at the time the papers were signed. If those responsible for the incorporation knew of this at the time and wilfully violated the law, it cannot be said that they had made a bona fide attempt to comply with the law. If, however, the infant incorporator appeared to be of age and there was no reason for questioning him on that point, the corporation would undoubtedly exist in fact; it would be a *de facto* corporation.

Where neither a *de jure* nor a *de facto* corporation is created, the persons associated are considered partners with all the obligations of partners. Hence the importance of determining whether an improperly incorporated company is at least a *de facto* corporation.

## REVIEW

Upon what theory do some States deny the right to incorporate to lawyers, doctors or dentists?

What are some of the important "implied" powers of corporations?

How explicit should incorporators be in their definition of the purposes for which incorporation is sought?

What incidental rights would a corporation have which had been formed to promote the development of a plot of land?

Distinguish between foreign and alien corporations; between *de jure* and *de facto* corporations.

[1] The Dominion Companies Act provides that not less than five persons must apply for incorporation.

# CHAPTER IX

## INCORPORATION OF COMPANIES

1. *The corporate charter.*—In early times corporate charters were granted by the king. Later this prerogative was taken over by Parliament, and when the colonies became independent the right was vested in the state legislatures. The Federal Congress has power to incorporate companies to do any of the things over which Congress has been given jurisdiction by the Constitution. Thus, because the national government may borrow and coin money, Congress may form—and has formed—national banks. Because Congress can regulate interstate commerce, it may give charters to companies engaged in interstate commerce. Indeed, it is urged that a necessary step in the solution of many vexing railroad problems is the incorporation of the railroad companies under Federal law.

Similarly, the Dominion Parliament may incorporate companies to do any of the things over which, by the Constitution, it has been given jurisdiction. Certain subjects are within its exclusive jurisdiction, such as banking, so that we find a Dominion Bank Act and no other. In Canada there is a Dominion Railway Act, under which any railway wishing to operate as

an interprovincial or international railway must seek incorporation, and then of course only by special act of the Dominion Parliament. The various provinces have their own railway acts governing railways purely provincial. Industrial companies intending to market their goods thruout Canada now seek Dominion incorporations, almost without exception, as there has been considerable doubt raised as to the right of a locally chartered company to engage generally in interprovincial trade.

At first each company was formed by a special act of the legislature. Thus many of the canal and turnpike companies have special charters. For example, Chapter 21 of the Laws of 1793 of Massachusetts is an act the sole purpose of which is to give certain persons the rights and privileges of a corporation for the purpose of building and managing the Middlesex Canal. It can readily be understood that when the granting or withholding of a charter, and the powers of the grantee were wholly a matter of legislative discretion, that the door was opened for all sorts of corrupt practices. Moreover, it is obvious that such a procedure gave no guarantee in the uniformity in the powers accorded to corporations, and in fact the widest diversity prevailed. It was to remedy such conditions and to remove from the legislative proceedings the consideration of a mass of questions of no general concern to the people of the states that the present practice of granting corporate charters was adopted. About 1811, in order to facilitate the formation of

companies, general incorporation acts were passed which did away with the necessity of applying to the legislature for each separate charter. According to the provisions of these general acts a paper, called a certificate, or articles of incorporation, is drawn up, and if approved as not being in contravention of law, is filed in designated public offices.

In many states, as in New York, more than one general corporation act is on the statute books. In that state the so-called general corporation law applies to all corporations; the so-called stock corporation law applies to stock corporations—as distinguished from incorporated clubs, churches, etc., which do not issue transferable shares of stock; finally there is a series of corporation laws governing special forms of business. Thus railroads incorporate under the railroad law and banks under the banking law, while ordinarily, industrial or mercantile companies incorporate under the business corporation law. The arrangement of corporation laws, of course, is not the same in every state.[1] But if New York be taken as a model, it may be said that the charter of any ordinary business corporation consists of the general corporation law, the stock corporation law, the business corporation law and the articles of incorporation filed in the office of the Secretary of State.

2. *Special requirements for incorporation.*—It is a well-established principle that as corporations are

[1] For a compilation of corporation laws see "Corporation Manual," published by the Corporation Manual Company, New York.

creatures of the state, the latter can by law determine all the conditions of incorporation and exercise whatever power it sees fit in supervising and controlling the operations of corporations. Yet as a matter of fact the inspection and control which the state actually exercises over the business operations of corporations chartered under the general incorporation act is for the most part only formal.

This, however, is not the case with corporations engaged in lines of business which are quasi-public in their character, which involve a grant to the corporation of the exercise of some power inherent in the Government itself, and others in which the public as a whole has a special interest. In the first class belong the railroads and other public utilities, in the second, banks and insurance companies. Over these lines of business, Governments, both national and state, have established in the interest of the community at large a supervision which is often irksome to the enterprises themselves. In the main this supervision was at the outset devoted chiefly to the operations of companies already in existence founded often under special charters.

It was, however, soon extended to the establishment of new companies, and thus came to take cognizance of their organization and financial status as well as the service rendered to the public. Thus grew up a series of special laws governing the establishment of these particular enterprises which oftentimes in important respects lay down rules different from or in

amplification of the rules embodied in the general incorporation acts.

Without entering into the endless detail of such special legislation it is sufficient to point out that the state officials having the supervision of these several branches of business (railroad commission, public utility commission, bank commissioner, insurance commission) play an important rôle in deciding whether or not a certificate of incorporation shall be issued. Not only must the rules established for corporations in general be complied with but the conditions of the special laws must be fulfilled.

3. *Certificate of incorporation.*—We are chiefly concerned in this volume with general business corporations, and may now examine the procedure in forming them. The first step is to draw up in accordance with the law of the state a certificate of incorporation and submit it to the Secretary of State for his approval. The general nature of such a certificate can be seen from a consideration of the requirements of New York State. There it must contain nine clauses:

1. Name of the corporation. Usually the name ends with the word "corporation," but if not there must be added "Inc." or "Incorporated."

2. Purposes for which it is to be formed.

3. Amount and kinds of capital stock.

4. Number of shares into which the capital stock shall be divided (each of the par value of between $5 and $100), and the amount of the capital (not less

than $500) with which the corporation will begin business. Under a recent enactment, stock may be issued without par value.

5. Location of the principal office.

6. Duration, which may be perpetual.

7. Number of directors.

8. Name and post-office address of each of the directors for the first year.

9. Name and post-office address of each of the incorporators, and the statement of the number of shares of stock which each agrees to take.

Many other provisions may be inserted; the corporation laws of most states provide that certain powers can be exercised by the corporation only when the certificate so provides. It is quite necessary, therefore, to study the laws of the jurisdiction in which the corporation is proposed to be organized, to determine whether any powers that the corporation may care to exercise must be included in the certificate.

A certificate of incorporation usually may be amended by a two-thirds vote of the stockholders. In most states the certificate required by the statute is similar to that of New York, given above, except that Sections 7 and 8 may be omitted; the directors not being chosen until the first meeting of the stockholders is held and the number of directors being fixed by the by-laws.

4. *Organizing a corporation.*—The certificate of incorporation must be signed and acknowledged by the

incorporators and then sent to the Secretary of State. In New York the certificate need not be executed at a formal meeting. In Massachusetts and some other states the incorporators meet, execute their articles of agreement, and then submit the latter accompanied by the minutes of the meeting to the proper state officer. The latter examines the papers carefully to see whether they comply with all the provisions of the law. The most usual cause for complaint arises from the fact that the proposed certificate contains powers which an ordinary corporation cannot exercise unless there has been an attempt to organize it under the provisions of some special corporation act, such as the banking law, the insurance law, the transportation law or the education law. If objection is made by the Secretary of State, the proposed certificate is returned to the incorporators, and they either omit the objectionable clauses or else entirely abandon the certificate and organize under the provisions of the special corporation act.

If the Secretary of State accepts the certificate, an organization tax is paid—varying in amount in the different states—to the state controller or state treasurer, and a duplicate copy of the certificate is filed with the clerk of the county in which the principal office of the corporation is to be situated. After these formalities have been observed, a meeting of the incorporators is held to elect directors (in New York the directors for the first year are appointed by the certificate), to adopt by-laws, and to provide for rais-

ing capital thru the sale of the capital stock of the corporation. In many states the certificate must be published, for a certain length of time, in one or more newspapers in the county in which the principal office is to be located. After the papers have been filed, as above set forth, the meetings of the stockholders and the directors have been held and the certificate has been properly advertised, the formation of the corporation is complete.

5. *Incorporating in Canada.*—The procedure under the Companies Act of the Dominion of Canada leading to incorporation may be briefly outlined as follows:

Not less than five persons may apply by way of petition to the Secretary of State for letters patent incorporating them as a company for any of the purposes or objects to which the legislative authority of the Dominion Parliament extends, except the construction and working of railways or of telegraph or telephone lines, the business of insurance, the business of a loan company, and the business of banking and the issue of paper money.

The applicants must be at least twenty-one years of age. They sign the memorandum of agreement, subscribe for at least one share each and accompany their application with the following particulars:

(a) The proposed corporate name of the company, which must not be that of any other known company, or liable to be confounded therewith, or otherwise objectionable.

(b) The purposes for which incorporation is sought.

(c) The place within Canada which is to be its chief place of business.

(d) The proposed amount of its capital stock.

(e) The number of shares and the amount of each share.

(f) The names in full and the address and calling of each of the applicants, with special mention of the names of the provisional directors.

(g) The amount of stock taken by each applicant. The petition must be signed by each of the applicants in person, in presence of a witness. An affidavit establishing the sufficiency of the Petition and Memorandum of Agreement and another verifying the signatures of the Petition and Memorandum.

The Petition must be accompanied by the appropriate fee which varies with the amount of the capitalization. Thus, when the capital is $50,000 or less, —$100; when more than $50,000 and not more than $200,000—$100, and $1.00 for every $1,000 or fractional part thereof in excess of $50,000; when more than $200,000 and not more than $500,000—$250, and 50 cents for every $1,000 or fractional part thereof in excess of $200,000; when more than $500,000—$600, and 20 cents for every $1,000 or fractional part thereof in excess of $500,000.

Notice of the granting of the letters patent is given by the Secretary of State by two insertions in the *Canada Gazette*. Thereupon the company is deemed

incorporated. The company must in addition insert the notice of incorporation on four separate occasions in at least one newspaper in the county, city or place where the head office of the company is to be. This notice is inserted at the company's expense. The penalty for failure of the company to publish this notice is $20 a day.

The company shall not commence its operations or incur any liability before 10 per cent of its authorized capital has been subscribed and paid for.

It is well worth noting here, since many companies have been heavily mulcted by informers for neglect of the precaution, that every such company must keep its name, with the word "Limited" after the name, painted or affixed in easily legible letters, in a conspicuous position on the outside of every office or place of business of the company. The word "Limited" must also appear in the company's seal, and on its letter-heads, bill-heads, bills of exchange, promissory notes, receipts, and so on.

When it is proposed to form an insurance, banking or transportation company, or some other corporation in which the public at large will have an interest, the formalities upon organization are more complex and intricate. Usually a greater number of incorporators is required, and a larger paid-up capital. For example, in New York a proposed insurance company must have a large number of applicants ready to take out policies, and an educational corporation must have a valuable plant. In Canada, banks, rail-

ways and insurance companies are incorporated by special statute. A loan company, on the other hand, may be incorporated by letters patent granted by the Governor in Council—not by the Secretary of State.

6. *By-laws.*—The certificate of incorporation, along with the general corporation laws, is, as we have seen, the measure of the corporation power, its contract with the state and its statement of facts in which third persons may be interested. Every corporation sets forth in by-laws its internal organization. In this country and in Canada under the Dominion Companies Act, these are not filed in a public office—contrary, it may be observed, to the rule in England. Hence the by-laws carry no constructive notice to outsiders, tho members of the corporation are presumed to know their contents.

The by-laws usually provide for the following methods and policies: the methods of issuance and transfer of stock; the time and place of regular meetings of stockholders and directors; the manner in which these and special meetings shall be called; and the order of business in all meetings, and the number that shall constitute a quorum; the number, qualifications and terms of office of directors; the number of members and the powers of certain standing committees, as well as what shall be a quorum in each case; the titles, tenure, duties and powers of all officers; and the method of amending or repealing by-laws. To these may be added other provisions, including, for ex-

ample, rules for the custody of funds, the method of computing profits and of setting up reserves, and a statement of the times at which dividends shall be declared.

By-laws must not make it possible to show preference for one stockholder or group of stockholders rather than for another, for if they did they would be an instrument of oppression in the hands of a majority. They must not set unreasonable limitations upon the right of stockholders to transfer their stock, altho this does not include the denial of the company's right to demand payment of a stockholder's indebtedness to the company before releasing him. By-laws which are contrary to any provision of law, or which seek to prevent minority stockholders from applying to the courts to correct a wrong, are void.

By-laws are adopted, or amended in any way, by a vote of the stockholders. Usually a majority vote is all that is necessary tho in many jurisdictions a two-thirds or even a three-fourths vote is required. Directors are frequently given the right to add new by-laws, so long as they do not conflict with by-laws already passed by the stockholders. The practice in Canada frequently is for a by-law to authorize the directors to amend or repeal by-laws or make new ones, their action in these respects to have effect until the next general meeting of the company, when the action of the directors may be approved or disapproved.

7. *Where to incorporate.*—If a company is to do

business in several different states, the question of where it will incorporate will be determined largely by the nature of the corporation laws of the several states. Ordinarily, however, when most of the business of the company is to be done in one state and most of its property is located in that state, it will be expedient to incorporate there unless the laws of that state present some very definite hindrance to an important part of the plan of organization. This question need hardly arise in Canada, because, as we have already seen, under a Dominion or Federal charter the company may operate anywhere in the country.

8. *Questions to be considered before choosing a state.*—When the choice of a state depends largely upon the character of the corporation laws, very careful study should be made of the following questions:

(1) Is there any restriction in regard to the corporate name? In New York, ordinary business corporations are forbidden to use any one of a long list of designated titles. The prohibited names would not ordinarily be chosen, however, by the projectors of a general business company.

(2) Are there any restrictions as regards the purposes for which the company can be formed? In some states, corporations are not allowed to carry on certain lines of business unless they organize under special acts; and in other states, like Pennsylvania, a corporation cannot be organized to carry on more than one line of business.

(3) May the stock be conveniently arranged in dif-

ferent classes so as to distribute the control, income and risk in different ways among different groups of owners?

(4) Is there any limitation on the amount of indebtedness? In some states, bonds may not be issued to an amount greater than a certain proportion of the capital stock.

(5) May the number of directors be fixed in the by-laws? In New York, for example, the certificate of incorporation must be amended if the number of directors is to be changed. To obviate this difficulty, however, a large number may be provided for in the certificate of incorporation, while a smaller number only may be elected, the other positions being left vacant.

(6) Need any of the directors be residents of the state? A great many mining corporations were formed in Delaware, but at one time a local representative always had to be made a member of the board; this was a serious disadvantage. In 1915 the law was changed.

(7) Is it necessary to have a local agent? If so, the requirement is not so burdensome as that last mentioned, for in a great many states so-called incorporating companies exist for the sole purpose of providing the necessary agent.

(8) Must directors' meetings be held within the state? A provision to this effect is particularly burdensome, since directors cannot vote by proxy.

(9) Must the company maintain a principal office

in the state, and must stockholders' meetings be held there? Such a requirement is quite frequently found in the statutes, but it is not objectionable since stockholders vote by proxy.

(10) Is it necessary for directors to be stockholders? In a great many states, including New York and Massachusetts, by-laws may provide that directors need not be stockholders.

(11) Do stockholders have any unusual liabilities? In some states they are held strictly liable for wages, and in other states, such as Minnesota and California, there is some general liability to creditors in addition to the liability to pay for the par value of the stock.

(12) May stock be paid for at less than par, or in anything but cash?

(13) Is the duration of the company limited?

(14) Are there any burdensome requirements as to keeping the corporate and financial books in the state, or in regard to the number of annual reports that must be filed?

(15) Are there any provisions affecting the holding of stock in other corporations?

(16) Have the laws been well adjudicated? The internal management of a corporation is ordinarily governed by the law of the state in which the corporation was formed, no matter where an action is brought to enforce that law. The courts frequently interpret statutes to mean something quite different from what they may appear to mean to the ordinary layman. One of the most important statutes of this kind is

that found in the laws of New Jersey, Maine and other eastern states providing that stock may be paid for in property, and that in the absence of fraud the judgment of the directors as to the value of the property shall be conclusive. New Jersey and Maine have other laws, however, which state that any gross discrepancy between the par value of the stock issued and the reasonable value of the property for which it is issued, shall be considered sufficient to indicate fraud.

(17) Are the taxes burdensome? Some of the taxes to be considered are the organization tax, the annual franchise tax, taxes on indebtedness, taxes on transfers of stock and the inheritance taxes. The tax last named falls upon persons, whether living within or outside the state, who become stockholders by inheriting some of the capital stock of the corporation. There are always, also, the property taxes levied on corporations and natural persons alike.

9. *Deciding upon the state in which to incorporate.* —As was indicated above, the law is not the only question to consider in deciding in which state to incorporate. Practical questions of business expediency may arise. Ex-Attorney-General George W. Wickersham, in an address before the Graduate School of Business Administration of Harvard University, summarized the problem as follows:

> My whole purpose has been to emphasize, by illustrations drawn from the varying provisions of constitutions and statutes, the divergent elements which enter into the problem

where to incorporate; to show that it is not enough to select a state whose laws seem to be simple, inexpensive and free from official interference; that the matter cannot be determined by turning to one of the convenient handbooks of incorporation published by many of the law stationers or issued by the corporations whose business is to act in a state as the agent of corporations whose real business is conducted out of the state; but that it is necessary to carefully examine the laws of all the states where the business is to be carried on, and that a balance must be struck of the advantages and disadvantages attendant upon any particular selection. Quite apart from a choice based upon these, which may be called scientific reasons, there are also certain unscientific but often equally controlling considerations. Thus, there is a strong feeling among many business men in favor of incorporation in New Jersey, merely because it is understood that her attitude toward incorporation is liberal and encouraging, and because a very great number of large companies, including the United States Steel Corporation, the Standard Oil Compay of New Jersey, and others of the great industrial companies popularly known as "trusts," have been incorporated in that state; and it is assumed that their influence will count in favor of securing a continued conservative policy on the part of the legislature, as well as of the courts, and that smaller organizations will be safer there, under the wing, so to speak, of the great ones, than in some other state more newly embarked in the business of granting liberal charters to all comers at small expense, and few questions asked. But, as a matter of fact, the annual franchise tax imposed on all business corporations in New Jersey, added to the taxes enacted in many of the commercial states where they may carry on their business, makes it more expensive to maintain an organization in that state than in one of the states where the corporate business is really to be done; and the courts of New Jersey have been no more liberal in the construction of their statutes than those of many other states; in fact, they have gone very far in the reasoning employed, if not in the actual decision

rendered, in the recent case of Receiver v. Heppelheimer (69, N. J. Eq., 36) to destroy that provision of the New Jersey statute relating to the finality of the directors' act in fixing the value of property as the basis of a stock issue—a provision which is of more importance to the purchaser of stock than almost any other in the whole corporation law. On the other hand, there is a feeling among many members of the profession that laws such as those of Delaware and West Virginia are too loose to be resorted to for anything but speculative enterprises, such as mining companies and the like, and that it would not be desirable to form a substantial corporation under the laws of one of those states to carry on business elsewhere.

On the whole, my opinion is, that in the long run it will always be found better to incorporate in the state where the greater part of the property of the company is situated and its most important business conducted, unless the laws of that state present some very definite objection to some important provision in the plan of organization.

10. *Favored incorporating states.*—Business men, in incorporating, have shown a preference for certain states because they have the most favorable laws. In some states, like Delaware, Arizona, South Dakota, Maine and Virginia, an important attraction has been the low cost of incorporation. In some cases—in Delaware, Maine and Virginia—the attraction lies partly in the fact that both the incorporators and the directors may be non-residents. Moreover, these three states require only small annual franchise taxes of their corporations.

While, for example, in New York the annual tax [1] for a company incorporated for $5,000,000 is $7,500

[1] War legislation in some states has caused a radical change in tax rates.

and in New Jersey, $4,000, it is $150 in Delaware, $600 in Virginia and $2,525 in Maine. Nearly all the states that are popular with those who incorporate, allow an organization to pay for capital stock in property, services or labor as well as cash. This makes promotion easy. New Jersey is favored because it first permitted holding companies, and because its proximity to New York City makes executive control easy. Many of the largest corporations in the United States have large executive offices in New York City and maintain nominally their principal offices just across the Hudson River, in New Jersey. There is one office building in Jersey City which is the legal home of thousands of absentee corporations. The greatest number of companies are formed in New York State, since more business enterprises are situated there than in any other state. Its corporation laws are fair and have acquired a very definite meaning as a result of litigation in the courts.

In most of the so-called incorporating states, including all those mentioned, there are attorneys or corporations who make a specialty of obtaining charters. They advertise regularly where their announcements can be seen by business men and investors, and thus attract a great many undertakings to their states. Frequently these specialists publish pamphlets setting forth at length and in great detail the advantages that their states hold for corporations.

## REVIEW

Why did various state legislatures enact General Incorporation Acts? What are some of the Corporation Acts in New York State?

List the information that must be given to the Secretary of State in seeking his approval for a certificate of incorporation.

How may the certificate of incorporation be amended? How may the by-laws be amended?

What should incorporators consider in determining upon a state in which to incorporate?

# CHAPTER X

## DISSOLUTION OF CORPORATIONS

1. *Duration.*—Ordinarily the corporation contemplates continued existence, and generally speaking, corporations under the laws of most states can obtain perpetual charters. In others there is a limitation to a maximum of twenty or fifty years. A limitation to twenty years is fixed also in the National Banking Act. Such a limitation does not work in practice as a restriction since the maximum time limit is chosen by the corporation and reincorporation follows at its expiration. This can by various methods be arranged as a purely internal matter without interrupting the course of business. There is, perhaps, an advantage in this periodical opportunity for charter revision, tho the same results can usually be obtained thru the process of amendment.

The question of the duration of the charter is oftentimes quite important for older corporations organized before general incorporation laws came into vogue. At the present time practically all charters are granted subject to the right of the state to annul or modify them, but there is no such reservation in the earlier charters.

2. *Dissolution.*—As before noted, corporations

rarely expire but they are frequently dissolved either by the voluntary act of the corporation or by judicial or administrative order. Before the law on the subject of corporations was fully developed, directors of corporations, without consulting the stockholders, could frequently bring the corporation to an end by making an assignment for the benefit of creditors. At the present time the procedure in the case of dissolution whether voluntary or involuntary is generally regulated by statute.

3. *Voluntary dissolution of corporations.*—Private corporations are ordinarily permitted to dissolve at any time, provided they comply with the provisions of the corporation laws relating to dissolution. Public service corporations may not dissolve without first obtaining special consent from the state, since they are under obligation to carry out the purposes for which they are incorporated. The dissolution of public-service corporations is generally controlled by public-utility commissions.

In the voluntary dissolution of corporations the usual procedure begins with a resolution by the directors stating that dissolution is expedient and calling upon the stockholders to pass on the question. A special meeting of the stockholders is then convened, and if two-thirds of the stockholders in interest vote in favor of the dissolution, certificates are drawn up and filed in designated public offices.[1] Usually no-

[1] The Dominion Winding-up Act requires the passing at a special meeting of shareholders called for the purpose, of a resolution requiring the company to be wound up.

tices must be published in newspapers for a certain length of time in order to notify the public of the impending dissolution.

The effect of dissolution is usually to make directors trustees for the benefit of creditors and stockholders. The New York law on this point is typical.

> Upon the dissolution of any corporation, its directors, unless other persons shall be appointed by the legislature, or by some court of competent jurisdiction, shall be the trustees of its creditors, stockholders or members, and shall have full power to settle its affairs, collect and pay outstanding debts, and divide among the persons entitled thereto the money and other property remaining after payment of debts and necessary expenses.
>
> Such trustees shall have authority to sue for and recover the debts and property of the corporation, by their name as such trustees, and shall jointly and severally be personally liable to its creditors, stockholders or members, to the extent of its property and effects that shall come into their hands.[1]

4. *Involuntary dissolution of corporations.*—Corporations may ordinarily be dissolved by the state when they have not been properly incorporated or when they have committed any act which exceeds their lawful powers (*ultra vires*). It was on this latter ground that the North River Sugar Refining Company was dissolved in 1890 by the State of New York.

In many states, corporations may be dissolved for certain offenses of commission or omission; and here again we may take the New York law as typical.

[1] It is usual in Canada to appoint a liquidator as provided by the Winding-up Act, and inspectors to assist and advise him as well as to watch the interests of creditors.

In either of the following cases, an action to procure a judgment dissolving a corporation, created by or under the laws of the state, and forfeiting its corporate rights, privileges and franchises, may be maintained, as prescribed in the next section:

1. Where the corporation has remained insolvent for at least one year.

2. Where it has neglected or refused, for at least one year, to pay and discharge its notes or other evidence of debt.

3. Where it has suspended its ordinary and lawful business for at least one year.

4. If it has banking powers, or power to make loans on pledges or deposits, or to make insurances, where it becomes insolvent or unable to pay its debts, or has violated any provision of the act, by or under which it was incorporated, or of any other act binding upon it.

Under the Dominion Winding-up Act a winding-up order may be made by the court upon petition.

(a) Where the period, if any, fixed for the duration of the company by the Act, charter or instrument of incorporation has expired; or where the event, if any, has occurred, upon the occurrence of which it is provided by the Act or charter or instrument of incorporation that the company is to be dissolved;

(b) Where the company at a special meeting of shareholders called for the purpose, had passed a resolution requiring the company to be wound up;

(c) When the company is insolvent;

(d) When the capital stock of the company is impaired to the extent of 25% thereof, and when it is shown to the satisfaction of the court that the lost capital will not likely be restored within one year; or

(e) When the court is of the opinion that for any other reason it is just and equitable that the company should be wound up.

A company will be deemed insolvent under (c) above,

1. If it is unable to pay its debts as they become due;
2. If it calls a meeting of its creditors for the purpose of compounding with them;
3. If it exhibits a statement showing its inability to meet its liabilities;
4. If it has otherwise acknowledged its insolvency;
5. If it assigns, removes or disposes of, or attempts or is about to assign, remove or dispose of, any of its property, with intent to defraud, defeat or delay its creditors, or any of them;
6. If with such intent, it has procured its money, goods, chattels, land or property to be seized, levied on or taken, under or by any process of execution;
7. If it has made any general conveyance or assignment of its property for the benefit of its creditors, or if, being unable to meet its liabilities in full, it makes any sale or conveyance of the whole or the main part of its stock in trade or assets, without the consent of its creditors, or without satisfying their claims;
8. If it permits any execution issued against it, under which any of its goods, chattels, land or property are seized, levied upon or taken in execution, to remain unsatisfied till within four days of the time fixed by the sheriff or proper officer for the sale thereof, or for fifteen days after such seizure.

5. *Effect of death of members and of bankruptcy of a corporation.*—If all the stockholders of a corporation die, their heirs and legatees immediately take their place. If all the directors die, the stockholders may proceed immediately to elect new directors.

A corporation does not necessarily end its existence if it becomes insolvent; indeed, corporations may be

discharged in bankruptcy. There are several cases on record in which corporations have renewed their business after bankruptcy court proceedings have been concluded. This is not true of Canada, where there is no bankruptcy law. A company insolvent and wound up is a company no longer.

6. *Corporate receivers.*—A receiver is an impartial person appointed by an equity court to hold and administer any property which is the subject of litigation. Thus, when a large corporation which has many classes of bonds outstanding becomes insolvent, there is danger that the value of the business as a going concern will be lost thru the piecemeal seizure of the corporate property by the creditors. To protect this valuable property of the company a receiver will be appointed to manage the property until the rights of all the parties can be determined.

Receivers may be appointed not only when a corporation has become insolvent but also when there has been mismanagement on the part of the officers and directors, or when there is a deadlock in the corporation.

During receivership most of the ordinary powers of the corporation are taken over by the receiver. The powers of the receiver are given by the general law of the state, by the order of the court appointing the receiver and by such subsequent orders as may be made from time to time. In fact, the receiver has sometimes been called the "right arm of the court." His possession of the property is really the possession of

the court, and nobody can interfere with the property unless permission is first received from the proper court.

7. *Qualifications of a receiver.*—The chief qualification of a receiver is that he should be impartial. At one time this requisite was stretched to such an extent as to exclude practically all who had in any way been identified with the enterprise. Stockholders and directors are not ineligible as receivers, but at one time the courts were very reluctant to appoint them. Indeed the banking laws of New York still provide that an officer or director of a bank cannot be appointed as a receiver of the bank. But of late years there has been a tendency in the contrary direction as the courts have felt that the corporation in difficulty should have the benefit of the special knowledge and experience of those who had handled its affairs.

In the case of railroad receiverships, and others in which a large amount of detailed knowledge is necessary, in order that the property should be properly administered, it has become customary for the court to appoint some one formerly connected with the company. Some of the receivers so appointed have not been wholly disinterested in their actions. Various abuses have often crept in as a result of these "friendly receiverships." One authority finds that in 80 cases out of 150 in which railroads passed into the receiver's hands, the former president was appointed a receiver, while in 58 other cases other officers of the company served in this capacity. The heavy financial interests

held by these officials have sometimes restrained them from disclosing the real condition of the property, thereby hindering the work of reorganization which they were supposed to bring about. When the Frisco railroad went into the hands of the receiver, the actions of the receiver appointed were found to be so biased that stockholders petitioned the court for his discharge. The court granted the request. To avoid abuses, the courts have sometimes appointed two receivers, one to represent interested parties, and the other because of his familiarity with the business.

8. *Dissolution in Canada.*—So far at least as Canada is concerned the foregoing statement as to receivers is insufficient. In the province of Quebec, the term "receiver" has no legal signification, and the word "sequestrator" should be substituted in trust deeds or in actual proceedings otherwise taken for an appointment. In Canada trust deeds usually authorize the trustee or trustees to take possession of the property covered by the charge and to administer it, or to sell it. The trustees of corporate mortgages are now usually incorporated trust companies, and the power of entry, administration and sale can be as well exercised by such a company as by the appointment of a receiver or sequestrator; tho trust deeds often provide for the appointment of a receiver, manager or sequestrator at the instance even of the trustee. Such a receiver would, upon the event happening, take possession of the property and manage the business in the interest of the bondholders. Such a

receiver also is not an official of any court. Unless the trust deed otherwise provides he is the agent of the persons by whom he was appointed—the bondholders, tho for some purposes he may be the company's agent. Thus the trust deed may recite that a receiver so appointed shall be deemed the company's agent, and that the company alone shall be responsible for his actions. This would protect the bondholders or their trustees from liability as mortgagees in possession. Moreover, the bondholders may appoint a receiver under such a power even after the appointment of an official liquidator in a winding up, and the court will not ordinarily displace the receiver in favor of the liquidator.

## REVIEW

Under what limitations are charters usually granted to corporations?

State the steps necessary for the voluntary dissolution of an industrial corporation.

What would take place in the affairs of a corporation if all the stockholders should die?

Under what conditions will a receiver for a corporation be appointed? What procedure is necessary when stockholders desire the appointment of a receiver to protect their interests?

# CHAPTER XI

## STOCK AND DIVIDENDS

1. *Stock.*—The aggregate of all the interests of all the owners of a corporation is called stock. It is divided into units known as shares. A share of stock is a unit of ownership in a corporation, not in the corporate property, but in the corporation itself. It is important to remember this distinction. The corporation owns the property and the stockholders own the corporation. The stockholders' ownership is merely a collection of rights which must be observed in the management of the corporate business.

2. *English nomenclature.*—In England, the definitions given above do not hold good. Because the English nomenclature is sometimes referred to in this country, the reader ought to understand the English practice. In that country when a company is first formed it issues shares. The shares remain as such until they are paid-up, at which time they may be converted into stock. Stock, therefore, can exist only in the paid-up state. Shares exist in unit form and each is given a separate number. Thus, for example, the title to share number 7 can be traced from owner to owner, while in the United States, on the other hand, one share is like another, without individuality,

even in respect to having a number. When paid up shares are converted—"consolidated" is the term frequently used—into stock in England, the stock is considered as existing in bulk and not in number. Stock "is, in fact, simply a set of shares put together in a bundle." [1] Thus, while shares usually have a par value of say one pound, consolidated stock may be bought and sold in any amount, say ten shillings, five shillings or even less. In all other respects stock and shares are alike. If a person has thirty-seven pounds, ten shillings of stock, and the shares have a par value of one pound, this person would have thirty-seven votes and would receive dividends equaling the prescribed rate applied to thirty-seven pounds, ten shillings. It will be seen, therefore, that the English practice is more flexible than the American, and has made unnecessary the clumsy device of fractional shares used here.

3. *Classes of stock.*—Stock may ordinarily be divided into various classes, each class being entitled uniformly to certain distinct rights. By dividing stock into classes a great flexibility is attainable in separating ownership into its three incidents: control, income and risk. Thus, one class of stock may be given voting power while another class may be limited in voting power or given none at all. Again, one class may be given larger dividends than another. It may take practically all the risk, either in the matter of getting an income from the company, or in re-

[1] Morrice vs. Aylmer (1875), L. R. 7 H. L. 77 at pp. 724, 725.

covering the capital invested upon the dissolution of the company.

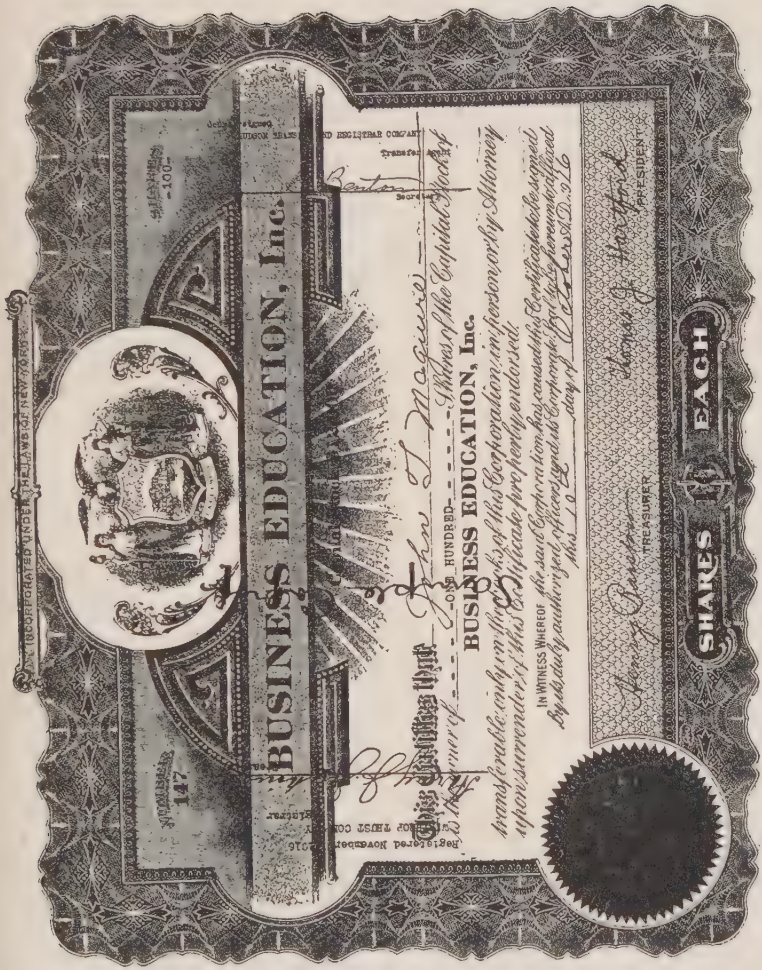
Formerly, division of stock was made chiefly to create different classes of income and risk. One class was then called common and the other preferred. Now, however, classes are frequently provided to allot to different persons, distinct degrees of control. It is not unusual nowadays, to hear of "Class A" stock, as in the case of the Perlman Rim Corporation, or some other arbitrary designation of the unusual class of stock.

4. *Certificates of stock.*—Shares are evidenced by certificates, each of which may stand for one or more shares. These certificates are assignable and, by very modern statutes, are made wholly negotiable. The record of ownership kept on the company's books, therefore, is not the conclusive evidence of ownership. Any bona fide purchaser of a certificate gets title to the stock. Title may also be passed by gift, by will or thru operation of law in seizing the stock to satisfy a judgment or lien.

5. *Transfers of stock.*—Transfers of ownership usually are made on the books of a company by a proper officer, called a transfer agent. The transfer agent may be either an independent agency, such as a trust company, or an employe of the company giving to this work only such time as it requires. While the certificate is negotiable and its ownership, under the rules relating to negotiable instruments, settles the question of title as between successive owners, the law

provides that, in the absence of actual knowledge to the contrary, the company will be justified in treating the person whose name appears on its books as the owner of the stock. This stipulation is designed merely to protect the company, but it does not justify a retention of any benefits by one who is not an owner but whose name appears on the books. Thus, if A indorsed his certificate in blank, and later lost it, and B found it and sold it to C, an innocent purchaser, for value, C would get title. Now if C neglected to transfer his ownership on the books of the company before a dividend was declared, the company, not knowing the true facts, would send the dividend check to A. But A would be compelled to turn the dividend over to C, the true owner.[1] The Canadian statutes, with rare exceptions provide that the receipt of the shareholder in whose name shares stand in the books of the company shall be valid and binding discharge to the company for any dividend or money payable in respect of such shares. Usually companies give notice that dividends will be paid on a certain day to shareholders of record on a date prior to the date of payment. So that in Canada the registered holder on such date would ordinarily receive the dividend, tho he might afterward and before actual receipt of the dividend have sold his stock.

[1] This rule prevails only in those states, including New York, Massachusetts and Pennsylvania, which have adopted the Uniform Stock Transfer Law. Since it is likely that the other states will sooner or later enact this statute, it has been thought advisable to explain the rule rather than to explain the common law.


BUSINESS EDUCATION, Inc.
INCORPORATED UNDER THE LAWS OF NEW YORK
SHARES
EACH
PRESIDENT
TREASURER
BUSINESS EDUCATION, Inc.
ONE HUNDRED
IN WITNESS WHEREOF
Transfer Agent
Secretary
Registered November 2016
147
-100-

6. *Lost certificates.*—If a stockholder loses his certificate he may procure a new one, under ordinary practice, by making affidavit to the facts, and by putting up a bond to protect the corporation in case the lost certificate is presented by a bona fide purchaser.

7. *Stock certificates as evidence of stockholders' rights.*—The stock certificate is only an evidence of the stockholder's interest in a company. The complete terms of his contract with the company is contained in the state, Dominion or provincial laws, in the certificate of incorporation and in the by-laws. Sometimes the clauses from the certificate and by-laws, describing special rights or limitations, are printed on the face of the certificate. Such clauses define the exact terms of preference in the distribution of profits, voting rights and the like. In other instances, however, the certificate merely calls to the stockholder's attention the provisions of the certificate of incorporation or by-laws bearing upon these questions.

8. *Dividends.*—Profits paid to stockholders are called dividends. They are usually paid in cash, but may be paid in scrip redeemable at some time in the future in cash, in stock, or even in property. A recent example of property dividends is found in the distribution of Anglo-French bonds to the stockholders of the Du Pont Powder Co.

9. *Who has the right to declare dividends?*—The directors, honestly exercising their discretion, have the

sole right to declare dividends.[1] Stockholders can compel the payment of dividends only when they can show the violation of a contract, or fraud on the part of the directors. Thus, a certificate of stock bearing the statement that the holder shall be entitled to dividends at the rate of 8 per cent, payable quarterly, on the first of January, April, July and October would give a stockholder the right to insist that the dividend shall be declared if the surplus is available. The stockholders gain this right thru the wording of the stock certificate in which there is an implied contract on the part of the corporation to declare and to pay these dividends. Moreover, if the stockholders can show that the directors refuse to pay dividends, in spite of a large surplus in the form of cash on deposit with banks in which the directors are personally interested, the former can probably get a mandatory injunction directing the payment of reasonable dividends.

10. *Sources of dividends.*—Dividends are paid only out of surplus or net profits.

The words net profits define themselves. They mean what shall remain as the clear gains of any business venture after deducting the capital invested in the business, the expenses incurred in its conduct, and the losses sustained in its prosecution.[2]

Dividends must be declared generally on all shares

1 On the question of how this discretion should be exercised see the Text on "Corporation Finance."

2 Park vs. Grant, 40 N. J. Eq. 114.

of the same class of stock. An agreement to pay a fixed dividend on any class of stock is valid so long as there are any profits out of which to pay it. Directors and officers who participate in the declaration and distribution of dividends out of capital are usually civilly liable to the injured parties and they may be prosecuted criminally.

Surplus need not be accumulated in the form of cash. If net profits of a corporation are tied up in property, the corporation may borrow cash to distribute as dividends.

11. *Who is entitled to dividends?*—After a dividend is declared, the amount apportioned to the individual stockholder becomes a debt of the corporation, and the stockholder may sue for it as for any other debt. If the amount of the dividend is set aside in a separate fund or bank account, it becomes a trust fund in which the stockholder has a right superior to that of the creditors, in case the company subsequently becomes insolvent.

Dividends are treated as tho earned, when declared. The owner of stock at the time of declaration, not at the time of payment, is entitled to the dividend. Very frequently the declaration is made in this form:

A dividend of —— per cent is hereby declared on the capital stock of the company payable on May 1 to stockholders of record of April 15. Books will close at 5 P. M. on April 15 and remain closed till May 1.

The person owning the stock at 5 P. M. on April 15 is entitled to the dividend. If another person's name

is registered in the books of the company at that time, he will receive the dividend check but will have to account to the true owner of the stock.[1]

As to the Canadian law on the subject, Mr. Victor E. Mitchell, K. C., of Montreal, in his recent excellent treatise on Canadian Company Law, has this to say:

> To understand the position of those who acquire shares from the registered holder, in respect to the right to dividends derived therefrom, it should first be remembered that a share in a company merely confers on the holders thereof the right while the company is a going concern to a share in the profits when realized *and divided* by way of dividend or bonus. Consequently, when a shareholder disposes of shares, and nothing is said about dividends, there goes to the person acquiring them, all the incidents attaching thereto, the chief of which is to receive all dividends which accrue thereon on and after the date of the agreement by which title to the shares is passed. The dividends which have accrued prior to the date of agreement, even if payable thereafter, belong to the transferor, and those which have accrued subsequent to the date of agreement, even in respect to profits earned at any time prior thereto, belong to the transferee. It is usual in the sale of shares to express whether the sale is "cum div." or "ex. div."

12. *Ownership of dividends on securities bought and sold on the New York Stock Exchange.*—The ownership of dividends on securities bought or sold on the New York Stock Exchange is governed by the rules of the Exchange. Every contract of purchase and sale makes them a part of the contract.

1 Notice that the Uniform Stock Transfer Law decides the equities between contending stockholders but the corporation is always justified in relying on its records.

The number of transactions regularly consummated on the exchange is so large that it will be pertinent at this point to quote these rules at length:

ARTICLE XXXII. Sec. 1.[1] On the day of closing of the transfer books of a corporation for a dividend upon its shares all transactions therein for "Cash"[2] shall be "dividend on" up to the time officially designated for the closing of transfers; all transactions on that day other than for "Cash" shall be "ex-dividend."

Should the closing of transfers occur upon a holiday or half-holiday, observed by the Exchange, transactions on the preceding business day other than for "Cash" shall be "ex-dividend."

Sec. 2. The buyer shall be entitled to receive all interest, dividends, rights and privileges, except voting power, which may pertain to the securities contracted for, and for which the transfer books shall close during the pendency of the contract.

When such contract shall mature before the official date for payment of interest or dividend, the seller shall deliver a due-bill therefor signed or endorsed by him.

When a security is sold before the day of closing books for "Rights" (and is quoted "ex-Rights" on that day), and is delivered thereafter, the buyer shall on its delivery pay

[1] By-laws and rules N. Y. Stock Exchange.

[2] Bids and offers may be made only as follows:

(a) "Cash," i. e., for delivery upon the day of contract;

(b) "Regular Way," i. e., for delivery upon the business day following the contract;

(c) "At three days," i. e., for delivery upon the third day following the contract;

(d) "Buyer's" or "Seller's" options for not less than four days nor more than sixty days.

Bids and offers under each of these specifications may be made simultaneously as being essentially different propositions, and may be separately accepted without precedence of one over another.

Bids and offers made without stated conditions shall be considered to be in the "Regular Way." (From Sec. 3, Article XXIII of the Stock Exchange By-Laws and Rules.)

only the market price of the security "ex-Rights." He shall pay the balance due on the contract, when the seller delivers the "Rights," at any time on or before the day set by the Committee on Securities for settlement of contracts in "Rights."

When a security is loaned before the day of closing books for "Rights" (and is quoted "ex-Rights" on that day), and is returned thereafter, the lender shall on its return pay only the market price of the security "ex-Rights." He shall pay the balance due on the contract, when the borrower delivers the "Rights," at any time on or before the day set by the Committee on Securities for settlement of contracts in "Rights."

Sec. 3. A charge of one per cent may be made for collecting dividends. For scrip or stock dividends the charge shall be computed upon the market value of such scrip or stock.

No charge shall be made for collecting dividends accruing on securities deliverable on a contract.

Sec. 4. Offers to buy or sell dividends shall not be made publicly on the Exchange. The Chairman shall impose a fine of twenty-five dollars for each violation of this rule.

13. *Dividends on dissolution.*—Since the stockholders are owners and not creditors, they cannot participate in the proceeds of liquidation until every manner of debt has been paid. Whatever surplus is left, after the creditors have been satisfied, goes to the stockholders who share in each class in proportion to the number of shares held. One class, however, may be given preference over another. Thus, the holders of preferred stock, which is preferred as to assets, receive the full par value of the shares before any distribution is made to the holders of the common stock. Where nothing is said on this point in the cor-

porate charter, one class has no preference over another.

## REVIEW

What is stock and how may it be classified?

What are certificates of stock? How may they be transferred?

A owns certificate No. 5 for 100 shares of the X Company dated September 1, 1905. He endorses it in blank and loses it. B finds it and sells it to C who knew of the loss. C gives it to D, who sells it to E who knew nothing of its past history. E sells it to B. Does B get the title? What remedies, if any, would A have?

What are dividends? Who has the right to declare them? Who are entitled to them? What are their sources?

# CHAPTER XII

## STOCKHOLDERS

1. *Rights of Stockholders.*—The stockholders as a body are the owners of the corporation, and as such they undertake the risks incident to the enterprise and participate in its profits. They have the right to share in the proceeds of liquidation after all debts have been paid. To what extent profits shall be distributed as dividends is a question of the dividend policies of the company which concerns its operation rather than its organization and is properly treated in the Text on Corporation Finance.

The third incident of ownership is control and it is important to note how such control is vested in the stockholder. While the stockholders are the ultimate source of power in a corporation they can operate only thru their representatives, the board of directors. The control of the stockholders is very like that of the electorate in popular governments. It has the right to select agents to carry on the work. So long as the director remains within the law the stockholder cannot repudiate or contest his acts, any more than the voters can direct the course of action of a Congressman for example. But neither director nor member of Congress can expect continued tenure

after the expiration of the term for which he is elected unless he can satisfy the majority of its constituents, in other words obtain their votes at the next election. The control of the stockholder is, therefore, essentially a control thru electing representatives.

2. *Who has the right to vote?*—The right to vote belongs to the stockholders generally. It has been said that where securities are issued on the borderline between stocks and bonds, the right to vote given to the security holder conclusively stamps the security as a stock. While it is true that some companies have issued so-called bonds which give to the holder the absolute or contingent right to vote for directors, there is some danger that the courts will construe these securities to be ownership and not creditor instruments. If it is desired to give the bondholders the right to control, a voting trust arrangement similar to that used by the Hudson and Manhattan Railroad Company is recommended. This plan was described in the circular sent to the stockholders, in 1913, in connection with the readjustment of the company's finances as follows:

> The deposited capital stock of the Company is to be deposited with a bank or trust company under an agreement which will vest the voting power in respect of such stock for a period of five years from the date of the agreement in voting trustees to be named by the Readjustment Managers. Said Voting Trust Agreement shall provide that whenever and so long as five per cent interest had not been paid on all the Adjustment Income Bonds outstanding during the last preceding fiscal year, the persons elected to the board of directors of the Company shall be persons so approved or

nominated at a meeting of the holders of the Adjustment Income Bonds, until one less than a majority of the board of directors shall be persons so approved or nominated, provided that the action of the meeting of the holders of the Adjustment Income Bonds, approving or nominating the necessary candidates for election shall be taken within a reasonable time after the opportunity to do so is given.

3. *Depriving certain classes of the right to vote.*— A very usual provision in modern corporate charters divides the stock of a company into several classes, some of which, or all but one class, are not given voting power. It has been held that such provisions are entirely legal since the stockholders have the right to modify their normal rights by contract in any way they see fit. Sometimes the right to vote is taken from a class, but a provision gives this class the right to control the board if dividends are not regularly paid to it. A similar provision is found in the charter of the California Petroleum Company:

The preferred stock shall have no voting power except as above stated, and except that in case the Corporation shall fail for four quarterly periods to declare and pay the full regular quarterly dividend on the preferred stock, then and so long as there shall be any arrears of dividends upon the preferred stock the holders of record of the preferred stock outstanding, voting as a class, shall be entitled to elect the remainder of the board. If, however, all such accrued instalments and arrearages shall be paid by the Corporation at any time, then and thereupon the power of the preferred stockholders to elect directors shall cease, subject, however, to being again revived upon any subsequent failure of the Corporation to comply with the conditions herein stated.

4. *Special rights to vote on certain questions.*— Where the peculiar rights of a certain class of stockholders are likely to be affected by certain actions, that class is usually given a veto on the decision of the stockholders generally, with respect to such actions. Thus, the preferred stockholders of the California Petroleum Company, referred to in the previous section, tho not having the right to participate in the election of directors unless four quarterly dividends have not been paid, are given the right to veto the resolutions of the common stockholders on the following subjects and in the following manner:

Without the affirmative vote or written consent of the holders of at least three-fourths in amount of the outstanding preferred stock, the Corporation shall not:

(1) Change either by increase, diminution or otherwise the voting power of either the preferred or common stock as fixed in this certificate; or

(2) Sell, lease or otherwise dispose of the property, franchise and business of the Corporation in their entirety or any stock of any subsidiary company, or permit any subsidiary company to make such sale or other disposition of its property, except to the Corporation or some other subsidiary company; or

(3) Create or permit any subsidiary company to create any mortgage or other lien to secure an issue of bonds or otherwise, or permit any subsidiary company to issue any additional bonds under any present mortgage; or

(4) Create any shares of stock having priority over or on a parity with the authorized preferred stock, or permit any subsidiary company to issue any shares of stock without acquiring its proportionate part thereof; or

(5) Issue any of the authorized preferred stock in excess of $15,000,000 in the aggregate except for the acquisition of additional income-producing oil properties; or

(6) After October 1, 1913, issue any of the authorized preferred stock, in excess of $12,500,000 in the aggregate, unless the net earnings or profits of the Corporation available for dividends on the preferred stock for the last preceding fiscal year of twelve months shall have been at least equal to twice the annual dividends on the preferred stock outstanding and so to be issued.

5. *Referring matters to stockholders.*—As we shall see later, the ordinary every-day business of a corporation is managed by the board of directors. Under modern statutes, however, certain questions are of such grave importance to the stockholders that actions of the directors concerning them must be referred to the stockholders, and must receive the sanction of a large majority, usually two-thirds or three-fourths, before the company can proceed. Such questions include the consolidation of the company with other corporations, mortgaging all the corporate property, selling or leasing it, and dissolving the company. In brief, any action which affects the entire property of the company, or changes the corporate charter, is usually required by statute to be placed before the stockholders.

Again the analogy with political action is helpful in understanding the relation of the stockholders to the corporation. The ordinary governmental affairs are conducted by the people's chosen representatives, but at times questions arise which are submitted directly to the people. Such is the case with changes in the constitution either when a new constitution is proposed, or amendments to the constitution are to be

acted upon. Such is sometimes the case with questions of great concern to all, such as contracting funded debt under certain conditions.

In corporations, questions analogous to those mentioned in the preceding paragraph are not decided by the directors, but are submitted to the decision of the stockholders.

6. *How many votes has each stockholder?*—Under the common law each stockholder has but one vote, irrespective of the number of shares held. In most jurisdictions this rule has been changed by statute and the stockholder is entitled to as many votes as the number of shares he holds. This rule, of course, may be modified by contract and it is possible to give a stockholder one vote for two or more shares; one vote for each share up to five shares; or one vote only for each two or more shares above five. The usual practice, however, is to give each share of stock of the voting class, one vote. The other practice, that of giving one vote to a share up to a certain number only, was used frequently in the promotion of middle western railways. It obviated the objections of the farmers who claimed that their small holdings would be worthless when pitted against the large holdings of the city capitalists.

An example of the earlier view is found in the restrictions placed on stockholders in the first and second United States Bank. For a stockholder to be entitled to vote, his stock must have been held by him for three months previous to the election. Only

stockholders who were actually resident within the United States could vote by proxy. Voting power was based on the number of shares held according to the following plan.

> "For 1 share and not more than 2 shares, 1 vote
> For every 2 shares above 2, not exceeding 10, 1 vote
> For every 4 shares above 10, not exceeding 30, 1 vote
> For every 6 shares above 30, not exceeding 60, 1 vote
> For every 8 shares above 60, not exceeding 100, 1 vote
> For every 10 shares above 100, 1 vote
> No person to have more than 30 votes."

Building and loan associations are another form of organization which have considerable analogy with corporations and in which voting restrictions are made very rigid. The principle of "one man, one vote" often obtains. For example, under Massachusetts law no member of a building society can cast more than a single vote whether he owns one share or twenty. Voting must be in person and no proxies are admitted. In New Jersey proxies are admitted in elections but no member can have more than one vote. In New York and in some other states the by-laws of the associations fix the qualifications of voters and the manner in which votes are cast.

7. *Between successive and between joint owners, who has the right to vote?*—As between the seller and purchaser of stock, the former is entitled to vote until the shares have been transferred on the books of the company. In some states the rule is that the purchaser may vote if the corporation has notice of his

interest, even before the formal transfer has been made. As between a bankrupt and his assignee, the former is entitled to vote until the latter registers his ownership with the company, in spite of the fact that the Bankruptcy Act vests in the assignee the title to all the bankrupt's property. A surviving partner may vote on the stock standing in the name of the firm, and usually an executor or administrator may vote on stock before a transfer is made on the company's books, by exhibiting his letters of appointment or a certified copy thereof. When shares are owned by two or more persons, all must agree or the shares cannot be voted, but any one may vote all the shares if the others do not object. If the corporation should become the owner of some of its own stock, it will have no right to vote them, but when a corporation is permitted either by statute, or by legal decisions, to hold shares of stock in another company the board of directors of the holding company may vote these shares.

Statutes and by-laws often provide for the closing of books during a certain period, usually about two weeks, immediately preceding the annual meeting. Transfers during that time cannot be registered and the sellers are entitled to vote.[1]

[1] The secretary of the New York Stock Exchange recently sent out the following letter on the practice of closing books. It would be a good thing if all corporations heeded the suggestion contained therein: "The committee feels that the closing of books is an unnecessary expedient; many of the larger corporations have long since abandoned this practice for the equally efficient and more satisfactory one of taking a record of stockholders on a fixed date. The old method of closing a

8. *Method of counting votes.*—Since shares, and not persons, are really entitled to votes under modern statutes, a vote unless unanimous, by standing, by "ayes and noes" or by showing of hands will be improper. Informal questions about which no dissent is expected may be placed before the stockholders without ceremony, but if any opposition develops, the vote should be taken by ballot, or by call of roll, and in either case the shares voting on one side or the other should be counted.

9. *Cumulative voting.*—In some states stockholders must be permitted to vote on the cumulative plan; in other states the question is left to the charter or by-laws of each corporation. If nothing is said in the law of the state, or in the charter or by-laws of the company it would seem that straight voting must be used; i.e., each stockholder casts as many votes for

company's books results in the tying up of large sums of money at recurrent periods. For example, the capitalization of companies whose books are closed during March and whose stocks are listed on this Exchange amounts to nearly three billion dollars; for April this amount is a little over one billion. This is capitalization, but in a recent month actual sales of these securities on a par of $100 represented $388,400,000 and $129,700,000 respectively. In a case of serious collapse of the market the inability to secure ready transfers must produce unfortunate situations. During panicky conditions small buyers have always appeared to purchase at the low prices for cash; this relief will be seriously impeded, because the dealers in small lots are prevented from splitting up the hundreds bought against such sales and are obliged to receive and carry the hundreds so purchased, while unable to secure from companies the smaller lots sold. This is a matter which as well interests lenders of money, where transfers of stocks are impeded, altho money is most needed, its circulation is interfered with, bankers are called upon to carry their customers for longer periods and for larger amounts than where deliveries are made day by day; some books are kept closed as much as thirty days."

each candidate intended to be voted for as equal the number of his shares. In cumulative voting, however, the votes may be accumulated and cast for one or any number of the candidates.

10. *The strategy of cumulative voting.*—The minority stockholders of a company may exercise their right to cumulative voting, when so permitted by the by-laws or charter, without proclaiming their intention. Hence it is possible under this system for a large minority, by careful planning and secrecy, to get a majority of the directors. Let us take an example where five directors are to be elected and the majority have 400 shares while the minority have 300. The minority's total vote is 1,500. Let us suppose, also, that thru ignorance, forgetfulness or avarice, the majority cast 400 votes for each position. The minority, by dividing their total number of votes equally among three candidates instead of among five, would elect their three candidates by pluralities of 100, and would have three out of five directors, which would give them control.[1]

11. *Proxies.*—Under the common law each stockholder was required to cast his votes in person, but under modern statutes and by-laws, votes may be cast by proxy. Under Canadian companies acts, generally speaking, votes may be given by proxy, if the proxy is himself a shareholder. Ordinarily, a proxy need be in no particular form nor need it be wit-

[1] The reader will find a number of interesting formulæ that will be helpful in matters of this kind in an article by the author in *The Journal of Accountancy*, Jan. 1, 1910.

nessed nor acknowledged. The following form of proxy is recommended:

CHICAGO, MILWAUKEE AND ST. PAUL RAILWAY COMPANY,
PROXY

Hereby constitute and appoint Roswell Miller, Albert J. Earling, John A. Stewart, William Rockefeller and Charles W. Harkness, or either of them, attorneys to vote as ..... proxy, according to the number of votes ..... should be entitled to vote if personally present, at the annual Meeting of the Stockholders of the Chicago, Milwaukee and St. Paul Railway Company, to be held at the office of said Company, in Milwaukee, on the 28th day of September, 1912, and at any adjournment or adjournments thereof and ..... hereby authorize and empower said attorneys or either of them to vote for ..... and in ..... name, place and stead for Directors; and to vote and act on any other business which may be brought before the said annual meeting, or at any adjournment or adjournments thereof, and generally in ..... name and stead, to vote and act in the premises as completely and effectually as ..... could do if personally present, and ..... hereby authorize said attorneys to appoint a substitute or substitutes, which substitute or substitutes shall have all the power above given to said Roswell Miller, Albert J. Earling, John A. Stewart, William Rockefeller, and Charles W. Harkness. Hereby revoking any proxy heretofore given.

In Witness Whereof ..... have hereunto set ..... hand this ..... day of ....., 1912.

While a stockholder who attends a meeting that is not called according to law would be estopped from denying the validity of the meeting, he may question its validity if it was attended by his proxy, since the

proxy is authorized to vote only at lawful meetings.

Large corporations generally send proxies along with the notice of a stockholders' meeting, and these proxies name a so-called proxy committee that represents the interests of the management. In this way continuity of managerial policy is insured.

In some states, as in New Jersey, a proxy becomes invalid in a certain period—say three years. In New York, proxies may be made for any definite time, but if not limited they are valid only for eleven months after their execution. Proxies are generally revocable at any time by the stockholder, irrespective of any agreement to the contrary between the stockholder and his representative.

12. *Right to maintain proportion of control.*—Three men, A, B and C agree to form a corporation, each one to have one-third interest. They form the corporation for $60,000, each taking $20,000 of the capital stock. Presently the company needs more money, and it is proposed to double the capital stock. A objects, on the ground that he is not financially able to take $20,000 of the additional stock, and that the increase without his participation would involve a breach of the contract in which he was given a one-third interest.[1] These facts illustrate the importance

[1] Of course A would have no standing in a court. His early contract was discharged by performance when the corporation was formed and he was given a one-third interest. If the statute says that the capital stock may be increased by a two-thirds vote of the stockholders, B and C may increase the stock and the corporation will discharge all its obligations to A by offering him one-third of the stock on the same terms that the stock is offered to others.

of the rule that each stockholder must be given the right to subscribe to increases of stock in proportion to his holdings. This rule maintains the proportionate control of the various parties in interest—majority and minority stockholders.

The right to subscribe need not be offered to the stockholders at par. It is sufficient if the price is not made higher than that at which the stock is subsequently offered to outsiders. If any of the stockholders refuse or neglect to exercise their right to subscribe, the other stockholders cannot insist upon taking their places.

13. *Form of negotiable rights.*—The right to subscribe to stock is usually given to stockholders in the form of certificates that can be negotiated in the market. Thus, if the stock is being increased twenty-five per cent each stockholder will be entitled to subscribe to stock, equal in amount to one-quarter of his holdings. If A owned twenty-three shares, he would probably be given two certificates; one would state that A is entitled to subscribe to five shares, and the other that he is entitled to subscribe to three-fourths of a share.

Fractional rights are bought and sold, and are consolidated to make up full rights. The full right and fractional right certificates look very much like certificates of stock, but are usually printed in different colors to be readily distinguishable. They contain complete statements of how and when the right to subscribe is to be exercised. Usually, a first payment of

ten per cent or more of the amount of stock subscribed for is to be made within a certain time, and subsequently instalments are to be paid at fixed periods. If the first payment is not made within the time limited, the right expires. If subsequent payments are not promptly made, penalties or forfeiture are prescribed. Payments are usually acknowledged on the certificate, and a form of assignment is printed on the reverse side in order that the certificate may readily be transferred at any time before final payment is made, when the certificate will be exchanged for a certificate of stock.

14. *Right of bondholders to subscribe to stock.*— Bondholders ordinarily have no inherent right to subscribe to stock. But when a company's stock is not selling far above par, so that the right to subscribe at par is not a sufficient inducement to the stockholder to take all the new stock, the bondholders make a very good class of prospects to whom the stock may be offered. It would seem, then, that if the stock is selling below par in the market, the company could make an offer to the bondholders to purchase some of it at par, since the stockholders could prove no damages.[1]

[1] When stock is selling above par and the stockholder is not given his customary right, he has a right of action against the company, and the measure of damages is the difference between the market value and par value multiplied by the number of shares to which the stockholder was entitled to subscribe. In a recent case before the Appellate Division of the Supreme Court of New York, the court held that the stockholder had a right to subscribe only to increases of capital stock, and not to any of the old capital stock that was unsold. The doctrine of this case is sound if applied to treasury stock (stock that has been issued but that has been donated to the treasury or has been purchased out of surplus) but not if applied to stock that has never been issued.

When corporations give their bondholders the privilege to buy stock, the privilege is usually tendered as an inducement when the bonds are offered for sale. The ten-year, 6 per cent, gold notes of the American Power and Light Company, dated August 1, 1911, were accompanied, when issued, by detachable option warrants, on surrender of which, and on payment of cash, holders may purchase at par, stock to an amount equal to the par value of the notes. Warrants, by their terms, are transferable until Aug. 1, 1921—the date of maturity of the notes. The noteholder, it will be seen, may either sell his warrant and keep his notes, or he may sell the notes and hold the warrants.

15. *Right of stockholders to subscribe to bonds and notes.*—The right to subscribe to stock, we have seen, is necessary to maintain proportionate control, and the common law right of the stockholder to participate in the purchase of new issues of stock is based on that principle. Bonds and notes do not affect the control of solvent corporations. We find, therefore, that stockholders have no inherent right to subscribe to these creditor instruments. To be sure, stockholders are good prospects to whom to offer bonds, and it is not unusual for the company to make a private offer to the stockholders before the general public offering is made.

16. *Conversion as a method of control.*—Very frequently bonds are issued convertible into stock. This is an inducement to prospective bondholders, since if the company prospers and dividends are increased,

the bondholder may convert his bond into stock which will have a higher market value.

The important incident of convertible bonds is in the opportunity which they give for influencing the control of a company. The historic war over Erie between Vanderbilt and Drew aptly illustrates our point. Drew and his retainers had been enjoined by a New York court on the petition of Vanderbilt from issuing additional stock. It was the purpose of Vanderbilt to get a corner in Erie and eventually to oust the ring—Fisk, Gould and Drew—from the management. The strategy of the latter consisted in issuing convertible bonds which were promptly transferred to an outside person who demanded their conversion. Upon perfunctory refusal, an injunction was sought and obtained directing the conversion of the bonds. Thus was everything made "legal."

When Vanderbilt's brokers began the bidding on the day set for the corner they were first amazed and then horrified at the prompt offers and deliveries of the stock.

> Wall Street had never been subjected to a greater shock and the market reeled to and fro like a drunken man between these giants, as they hurled about shares by the tens of thousands, and money by the million. When night put an end to the conflict, Erie stood at 78, the shock of battle was over, and the astonished brokers drew breath as they waited for the events of the morrow. The attempted "corner" was a failure, and Drew was victorious—no doubt existed on that point.[1]

[1] W. Z. Ripley, "Railway Problems," p. 20, quoting "From Chapters of Erie and Other Essays," by Charles Francis Adams and Henry Adams.

17. *Control thru redemption.*—The right to redeem stock at the option of the directors is frequently included in the contract with preferred stockholders. When the latter have the right to vote, the redemption feature may be used by the management to reduce an outside majority to a minority. The clash between the Hill and Harriman interests in 1901 over Northern Pacific is a classical example. Their efforts to get control, it will be remembered, carried the market to the $1,000 mark. Many Wall Street operators sold short at the time, not knowing that these giants, the one backed by J. P. Morgan and Company, the other by Kuhn, Loeb and Company, were buying the stock for actual delivery to get the voting power.

The Northern Pacific had outstanding $80,000,000 common stock, and $75,000,000 preferred. J. J. Hill (the president), and J. P. Morgan and Company together owned common stock amounting to $26,000,000. Harriman and his backers bought up $37,000,000 common and $42,000,000 preferred, which gave them a clear majority of $1,500,000 of all the stock of the road. The Hill interests bought more stock until they had $42,000,000 common, and thus gained a majority of $2,000,000 of the common. Then the Harriman people discovered their weakness. The preferred stock possessed equal voting power with the common, but was subject to redemption at par after the first of January, 1902. The annual meeting, however, was to occur in October. The Hill in-

terest could retain power only by getting a postponement of the meeting until after the 1st of January, when they could redeem the preferred stock. A threat on the part of the Hill interests to make this move brought about a compromise whereby all the stock held by the two interests in the Northern Pacific and the Great Northern was turned over to a holding company known as the Northern Securities Company.

18. *Liabilities of stockholders.*—The states are not all in agreement on the liability of stockholders. Such a diversity exists in the rules, especially in relation to liability to pay for stock, that the reader, if he cares to pursue the subject further, must refer to the statutes themselves. At common law, stockholders were required only to pay into the company the amount agreed upon, irrespective of the par value of the stock. In some states the liability is made to exist up to the amount of the par value of the stock, any other agreement being illegal. In a few states, however, among which is New York, the stockholder is liable to pay only the agreed amount to the corporation, but if the company becomes insolvent, he is liable to the creditors for the difference between the amount already paid in and the par value of the stock. The difficulties presented in this subject are made clear by the use of the device of stock without par value—a device which is being largely used in the creation of new stock. In such cases the stockholders are liable to pay the amount fixed in the cer-

tificate by the stockholders or the directors; usually the charter gives the directors the right to fix the price at which stock without par value shall be sold.

There is also conflict among the states as to the liability of the successive owners of stock. In New York, Indiana and New Hampshire only those shareholders are liable who were shareholders when the debt was contracted, and this liability survives the transfer of their shares. In Connecticut and in a few other states, only those shareholders are liable who held shares when the action by the creditors was commenced. In Illinois, all shareholders who were such, either at the time the debt was contracted, or who became shareholders prior to the commencement of the action, are held liable.

In some states stockholders have additional liabilities. In California, stockholders are liable for all debts of the corporation, in proportion to their stock interests. In Minnesota, stockholders have a double liability except in manufacturing and mechanical corporations. In Arizona, stockholders are liable for all debts of the corporation unless otherwise provided in the charter. In a number of states notably Massachusetts, New York, Pennsylvania and Indiana, stockholders are liable for wages due. Wisconsin imposes a double liability for certain labor claims.

In addition to special liabilities a number of states grant special exemptions. Preferred stock whether full paid or not is exempt from claims of creditors in

New Jersey, Delaware, Indiana and New Mexico. In Ohio preferred stock is liable only after common stock liability has been exhausted. In Michigan preferred stockholders are only liable for labor debts. Unless preferred stock is given voting power it is not liable for debts of the corporation in Tennessee.

The Canadian law on the subject may be briefly stated as follows: Without express provision, no member of a corporate body is individually liable for the corporate debts. When a person puts a certain amount of money into a company, paying for his stock in full the price demanded, and receives share certificates in return, he may lose what he has put up, but no more. If he has not paid up in full the price of the shares for which he has subscribed, and the company gets into trouble, he may be called upon to pay up the balance. This is what is meant by "limited liability." In the case of limited liability companies, by no internal regulations or by-laws could this limited liability be altered, either in favor of or against the shareholder. Most of the Canadian companies acts provide, however, for the joint and several liability of directors of a company to the "clerks, laborers, servants and apprentices thereof for all debts not exceeding six months' wages due for services performed for the company while they are such directors," but not unless the company has already been sued for the debt within a year from the time it became due, nor unless the director has been sued within a year of his ceasing to act as such, nor in either case before an

execution against the company has been returned unsatisfied.

19. *Forfeiture of stock.*—When a stockholder pays a deposit on his subscription, and agrees to pay further instalments at specified times, he may get a receipt for his money entitling him to nothing except the continuation of his contract, by the terms of which he is to get the stock upon the payment of the other instalments; or he may get the stock, usually with a statement that there are certain amounts due. If, when the amounts become due, either thru the lapse of the agreed time, or in pursuance to a valid call made by the directors, the instalments are not paid, the directors may forfeit the stock. In many states, stockholders may be prevented from transferring their stock till calls are paid. In some jurisdictions, forfeited stock is considered treasury stock and in other jurisdictions it becomes unissued stock.

20. *Kinds of stock.*—Attention has already been directed to the different classes of stock which confer different rights and privileges upon their owners. There are a variety of other expressions used in describing stocks with which the reader should be familiar. They relate in a general way to the financial status of the stock with respect to the company operations. They are applicable to any stock no matter to what class it may belong, whether common or preferred.

21. *Authorized stock.*—The terms in general use should be carefully studied by the reader. The stock

authorized to be issued by the certificate of incorporation is called authorized stock. It may be increased or decreased only thru amendment of the certificate as provided by statute. Most states fix a minimum of authorized stock for corporations but no maximum. Authorized stock is equal to issued stock, plus unissued stock.

22. *Issued stock.*—That part of the authorized stock which has been part-paid or full-paid is issued stock. It may be in the hands of outside stockholders or in the treasury of the company. Issued stock is equal to outstanding stock, plus treasury stock, and to full-paid stock plus part-paid stock.

23. *Unissued stock.*—The name given to authorized stock before issue is unissued stock. As was indicated above, in a great many jurisdictions this stock must be sold at par altho it may be issued for cash, property or services. When it is desired to sell stock at less than par, it is first issued for property of uncertain value, such as a patent, a mine, or the good will of a going business; but in the contract of issue, the property is appraised by the directors as being equal in value to the stock issued for it. Some of the stock is then donated back to the treasury; this treasury stock can then be sold at any price.

24. *Outstanding stock.*—Issued stock in the hands of outside stockholders is outstanding stock.

25. *Treasury stock.*—Stock that has been issued but has been brought back to the company by donation or purchase is called treasury stock. Generally

a corporation is permitted to purchase its stock only out of surplus. If it is purchased in any other way a corporation doing so thereby reduces its capitalization in fraud of creditors. Treasury stock, then, may be sold at any price since a sale below par will not reduce the company's capital but will cut down its surplus.

26. *Full-paid and part-paid stock.*—Stock which has been paid up to the agreed consideration or, in those states where stock cannot be issued at less than par, up to the par value, takes the name of full-paid stock. Stock which has not been paid for up to the par value or up to the agreed value is part-paid stock.

REVIEW

As a stockholder in the X Company what rights have you? As a controlling stockholder why should your choice of the Board of directors be careful?

What are the liabilities of stockholders?

What are proxies and how are they used?

What rights have bondholders to subscribe to stock? Stockholders to subscribe to bonds?

# CHAPTER XIII

## MEETINGS OF STOCKHOLDERS

1. *Stockholders' meetings.*—Stockholders are in most cases required to act in meeting, altho in some matters written approval of a question brought forward by the directors is all that is required by law. Very frequently corporations place matters before the stockholders which do not require their sanction, but which are more satisfactorily settled in this way. The directors are but the agents of the stockholders, and they act wisely when they refer very important matters to their principals.

Stockholders' meetings are either regular or special. In most cases the only regular stockholders' meeting is the annual meeting at which the directors are elected and the reports of the officers for the year are received.

2. *Place of meeting.*—In most states—the notable exception is Delaware—meetings of stockholders must be held in the state.

Some of the Canadian companies acts are explicit as to the place for holding general meetings; others are not, the matter being left to the discretion of the directors. The Ontario Act, for instance, declares that meetings of shareholders, directors and executive committees shall be held at the place of the head office

of the company except when otherwise provided by the special act, letters patent or the by-laws of the company, but shall not be held outside of Ontario unless when so authorized in one of the ways just mentioned. The Dominion Companies Act is less explicit: "Directors of the company shall be elected by the shareholders, in general meetings of the company assembled at some place in Canada." This is practically equivalent to saying that the annual general meeting at which directors are usually elected must be held in Canada, while the actual place of meetings is left to be determined by the letters patent or the by-laws. The Manitoba Act is to the same effect, except that meetings for the election of directors are to be held within the province. The place where annual meetings of the company may be held, may be fixed in the directors' by-laws provided the same is not contrary to law or the letters patent. The Quebec Companies Act provides that by-laws of the directors for the holding of annual meetings must fix the place of such meeting within the province. Apparently there is no such restriction as to special meetings of the company assembled at some place within the province. Under the New Brunswick Act, permission is given to hold annual meetings out of the province where such permission is applied for by the applicants for the letters patent, and the majority of the applicants are residents of Great Britain, the United States, or any province of Canada. The lieutenant-governor in granting the

letters patent may, if he deems it expedient, in any case, and upon application, grant permission to hold either shareholders' or directors' meetings out of the province.

3. *Notice of meetings.*—The statutes usually provide as to what notice must be given to the stockholders or directors if a meeting is to be valid, but in the absence of statutory regulation the certificate of incorporation or the by-laws govern. The notice must generally be given a reasonable time before the meeting is to be held so that it can be mailed to the last known address of each stockholder, and can be published in some paper of general circulation—tho this requirement is sometimes omitted. It must state the time, the place and the purpose of the meeting. The following notice is typical:

WESTINGHOUSE ELECTRIC AND MANUFACTURING COMPANY

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To the Stockholders of Westinghouse Electric and Manufacturing Company:

The annual meeting of the stockholders of the Westinghouse Electric and Manufacturing Company, will be held at the chief office of the Company, in the Borough of East Pittsburgh, Allegheny County, Pennsylvania, on Wednesday, June 12, 1912, at ten o'clock A. M., for the election of directors, and for the transaction of such other business as may properly come before the meeting.

The stock-transfer books will be closed on Friday, the 31st day of May, 1912, at three o'clock P. M., and will be reopened on the 13th day of June, 1912, at ten o'clock A. M.

Dated, New York, N. Y., May 18, 1912.

JAMES C. BENNETT, *Secretary.*

The present tendency is to make the notice more informal and to urge upon the stockholder the importance of his being represented at the meeting.

In many states notice can be waived. Small corporations generally obtain written waivers in the following form:

> We, the undersigned, stockholders of the Blank Corporation, do hereby waive all statutory and by-law requirements as to notice of a meeting of the stockholders of the said company to be held at the principal office of the company, No. 1681 West 50th St., on the first day of July, 1917, and we hereby consent to the transaction thereat of any and all kinds of business that may come before the meeting.

Where the waiver is permitted by law, it is becoming a regular feature in corporation practice. No matter how carefully the legal provisions in regard to notice are complied with, the waiver is requested as a further reenforcement of the legality of the action to be taken at the meeting.

4. *Transaction of business.*—Business need not be transacted with all the formality that is observed in deliberative bodies, but care should be taken to conduct meetings in a businesslike way, and to see that motions are definitely made, and that the sense of the meeting is clearly understood by all present after there has been a reasonable amount of discussion. When opposition to the management has developed, the utmost care should be exercised in regard to the method of calling and conducting the meeting.

On such occasions the company's legal adviser is not

infrequently invited to be present in order to see that all legal requirements are punctiliously complied with.

5. *Minutes.*—The most important part of a meeting is the minutes. It has been held that the minutes are merely evidence of what has occurred and that other evidence, such as the testimony of a member who was present, can be used to contradict the minutes. But in a contest between the corporation and an outsider it is always hard to overcome the testimony of the written minutes, especially if they are so worded as to show action against the interest of the corporation. Hence it is essential that the secretary exercise great care in wording the minutes.

It is customary in small corporations when only routine business is to be transacted at a stockholders' meeting, for the secretary to prepare a draft of the minutes before the meeting, and to read them before the meeting adjourns. This is a wholesome practice, for it commits the stockholders not only to certain actions but to the verbal expression of the action and does not place a heavy responsibility on the secretary.

6. *Form of minutes.*—So much is involved in having the minutes in unimpeachable form that it seems proper to ask the reader to consider carefully the contents of the minutes of a representative annual meeting [1] which follows:

The annual meeting of the stockholders of the New York, New Haven and Hartford Railroad Company was held, pur-

[1] From evidence taken before the Interstate Commerce Commission, relative to the financial transactions of the New York, New Haven and

suant to legal notice, at Harmonic Hall, No. 9 Elm Street, New Haven, Connecticut, on Wednesday, October 22nd, 1913.

President Howard Elliott in the chair.

The call for the meeting was read by the secretary as follows: *To the stockholders of the New York, New Haven and Hartford Railroad Company:*

Notice is hereby given that the annual meeting of the stockholders of the New York, New Haven and Hartford Railroad Company will be held in Harmonic Hall, No. 9 Elm Street, in the city of New Haven, Connecticut, on Wednesday, the 22nd day of October, 1913, at twelve o'clock noon, for the following purposes:

1. To act upon proposed amendments to the stockholders' by-laws, as follows:

Amend Articles III, IV, VII and IX by striking out the word "president" wherever it occurs and inserting in lieu thereof the words "chairman of the board," so that said articles as amended shall read as follows:

III. "The annual meeting of this corporation at which directors shall be chosen shall be held in the city of New Haven, Connecticut, on the fourth Wednesday of October in each year, at 12 o'clock M., at such place as shall be fixed by the chairman of the board of directors."

IV. "A special meeting of this corporation may be called at any time by order of the board of directors, and shall be held in the city of New Haven, at such hour and place as shall be fixed by the chairman of the board of directors."

VII. "For each annual and special meeting of the stockholders the board of directors shall appoint two tellers to receive and count the votes cast thereat. In case of the failure of the board of directors to make such appointment, or in case of the failure or inability of either or both of the tellers to serve at such meeting, the chairman of the board shall appoint another teller or tellers in his or their places."

IX. "All the meetings of this corporation shall be pre-

Hartford Railroad Company, together with the report of the Commission thereon.

sided over by the chairman of the board when he shall be present."

Amend Article X by inserting after the word "secretary" the words "or assistant secretaries," so that said article as amended shall read as follows:

X. "Minutes of all meetings of the corporation shall be taken and recorded by the secretary or assistant secretaries."

2. To elect a board of directors for the ensuing year.

3. To consider the annual statement and approve the acts of the directors and officers of the corporation as described in said statement and as reported at said meeting.

4. To transact any other business which may properly come before said meeting.

For the purpose of this meeting the transfer books of the company will be closed from October 8th, 1913, to October 22nd, 1913, both days inclusive.

Dated at New Haven, Connecticut, this 30th day of September, 1913.

By order of the board of directors.

ARTHUR E. CLARK, Secretary.

The affidavits of publication of the notice in accordance with law and the by-laws of the company were also submitted.

The following motion was presented by Clarence H. Venner, of New York, and duly seconded:

"That the secretary be and hereby is requested to read the minutes of the proceedings of the board of directors and the executive committee thereof since the last meeting" which, after considerable discussion, was amended on motion of ex-Governor Bulkeley and accepted by Mr. Venner, as follows:

"So far as they are applicable to any matters mentioned in the report which the stockholders are asked to approve."

On motion of Mr. W. A. Beardsley, duly seconded, it was voted to lay the resolution on the table.

The following resolution was presented by Mr. D. W. Blakeslee:

"*Resolved:* That the general statement of the affairs of the New York, New Haven and Hartford Railroad Company, prepared by the directors for the year ending June 30, 1913, and printed and distributed to the stockholders prior to this meeting, is hereby accepted, and the acts of the directors and officers of the corporation as therein described and as reported at this meeting are hereby approved and ratified."

"In favor of the acceptance of the annual statement for year ending June 30th, 1913."

Mr. A. Heaton Robertson offered the following resolutions, which were duly seconded and adopted:

"*Resolved:* That the stockholders' by-laws are hereby amended as follows:

"Amend Articles III, IV, VII, and IX by striking out the word 'president' wherever it occurs and inserting in lieu thereof the words 'chairman of the board'; so that said articles as amended shall read as follows:" [The minutes here contain a copy of the amended articles identical with the copy contained in the notice of meeting above.]

"*Resolved*, That action upon the resolutions just offered, and the election of directors, be by stock vote, and to avoid delay that stockholders be permitted to vote by ballot upon said resolutions and the election of directors at the same time."

On motion duly seconded, it was

"Voted, that the meeting do now proceed to vote upon the three questions submitted to this meeting."

It was also

"Voted, that after the votes are cast a recess be declared until 4:00 o'clock P. M."

The ballot box was opened to receive the ballots at 2:37 o'clock P. M., and at 2:49 o'clock P. M was declared closed, all having voted who desired to.

At 4:00 o'clock P. M, the tellers not having finished counting the ballots, the recess was continued until the completion of the count.

At 4:50 o'clock P. M. the meeting was again called to order and the tellers submitted the following report:

"*To the Chairman:*

The undersigned, tellers appointed to receive and count the votes cast at the annual meeting of the stockholders of the New York, New Haven and Hartford Railroad Company this day held, hereby certify:

That the whole number of votes cast in favor of the acceptance of the annual statement for the year ending June 30th, 1913, was 1,003,369 and against said resolution 10,193.

That the whole number of votes cast for directors was 1,013,562, of which there were cast for each of the following named:

[Here is written out a list of the candidates with the number of votes received by each. Those who were declared elected received more than a million votes each. Eleven other candidates were in the field but they received less than 1,500 votes each.]

That the whole number of votes cast in favor of the resolution approving amendments to the stockholders' by-laws was 1,013,562, and against said resolution none."

Dated at New Haven, Connecticut, this twenty-second day of October, 1913.

(Signed) SAMUEL HEMINGWAY,
(Signed) C. H. HEMPSTEAD,
Tellers.

Whereupon the chairman declared that the resolution approving the annual statement for the year ending June 30, 1913, had been adopted; that the following-named persons had been duly elected directors of the company for the ensuing year and until their successors shall have been elected and qualified, to wit: Messrs. William Rockefeller, Charles F. Brooker, Edwin Milner, William Skinner, D. Newton Barney, Robert W. Taft, James S. Elton, James S. Hemingway, A. Heaton Robertson, Frederick F. Brewster, Henry K. McHarg, John L. Billard, George F. Baker, T. DeWitt Cuyler, Edward Milligan, Francis T. Maxwell, Samuel Rea, Lawrence Minot, Morton F. Plant, J. P. Morgan, John T.

Pratt, Howard Elliott, W. Murray Crane, Arthur T. Hadley, James H. Hustis, James L. Richards, and Galen L. Stone; and that the resolution amending the stockholders' by-laws had been unanimously adopted.

The following resolution was offered by Mr. Clarence H. Venner and seconded by Hon. Morgan G. Bulkeley:

"*Moved*, That the directors and officers of this company be, and they hereby are, instructed to take no steps toward the issue and delivery of the $67,552,000 convertible debenture 6 per cent bonds until after the Supreme Judicial Court of Massachusetts shall have passed upon the legality of such issue on appeal, from and in review of the order of the Public Service Commission of Massachusetts."

On motion, duly seconded, it was

"Voted, That the resolution be laid upon the table."

On motion, duly seconded, the meeting adjourned (5:12 P. M.). Attest:

(Signed) ARTHUR E. CLARK, Secretary.

7. *Analysis of minutes.*—With the particular business of this meeting we are not concerned but it may be well to note somewhat in detail *how* it is recorded.

The record states where the meeting was held and not only recites that it assembled after a legal notice had been issued but incorporates the notice itself in the minutes, and notes that affidavits of publication were submitted.

In the subsequent course of the minutes, the name of each person presenting any motion, and sometimes the seconder is preserved in the record. Except for formal motions to lay on the table, each action is put in the form of a distinct resolution.

The record of the votes taken by ballot is in the

form of a report by tellers and is very specific as to the details of the vote.

In cases of special meetings it is a wise precaution to note at the outset the number of shares represented at the meeting in order to anticipate any question of a quorum. Where an action requires the vote of a fixed proportion of the whole number of shares in existence, it is a frequent practice to note in the minutes not only those for and against the proposition, but also the number of shares not voting.

The meeting illustrated here is that of a very large corporation in which the utmost formality is observed. But in good corporation practice it may be noted that the size of the corporation does not affect this question of formality. The most minute attention to detail is always to be recommended.

8. *Quorum at stockholders' meetings.*—The quorum necessary for the transaction of business is usually prescribed in the statutes or the by-laws. The statutory provision usually is to the effect that in the absence of a by-law on the subject, the presence of the holders of a majority of shares shall constitute a quorum. It must be remembered that the old common law rules declare that any number of stockholders not less than two constitutes a quorum. And the New York statute on the subject of annual meetings has been interpreted to mean that any number of stockholders who attend the annual meeting may proceed with the election of directors. Generally if a quorum is not present, those who attend may at least

adjourn to a later day, so that the subsequent meeting will be considered an adjourned meeting for which no notice is necessary.

Under Canadian practice it is customary for the directors to make provision for quorums of meetings of either shareholders or directors, and whether special or general. The Dominion and the Quebec Companies Acts both provide that such directors' by-laws are subject to approval or rejection by the stockholders. The Saskatchewan and Alberta Companies Acts both provide that no business shall be transacted at any general meeting *except* the declaration of a dividend, unless a quorum of members is present at the time when the meeting proceeds to business.

9. *Conduct of meetings.*—In the cut and dried formality of the usual corporation meeting there is about as much interest as in the proceedings of a political convention in which the steam roller has been well oiled and is skillfully guided. The stockholders display their interest and intelligence by staying away. Corporations with thousands of stockholders hold their annual meetings in rooms which will scarcely accommodate a score of persons. Two or three men with bags full of proxies are all that are required to conduct the proceedings decorously. They are usually diligent in securing the necessary authority to make the acts of the meeting legal.

It cannot be denied that in the actual procedure of corporate meetings there is an entire disregard of the theory that stockholders are the ultimate source of

power in the corporation. Perhaps it would be more accurate to describe them as a dormant source, tho it must be unusual circumstances indeed that jar them out of their sleep. If a test of strength comes between different elements among the stockholders, it is practically brought to an issue before the meeting takes place. Even in a contest the elements of excitement are found more often in the preliminary wire pulling than in the show down at the meeting.

10. *British corporate meetings.*—In contrast to the dull proceedings which are the rule in the United States, the meeting of a British company often supplies a dramatic interest. The stockholders seek it out, some in quest of information, some of excitement. And this all because the familiar traditions of political procedure, the heckling of a mass meeting, the questions and answers of Parliament have been incorporated into the proceedings of corporate meetings.

As in the United States, a printed report of the directors and officers is in the hands of the stockholders before the meeting. At the proper time it is moved that the report be approved and adopted. When this motion has been properly seconded the Chairman of the Board of Directors, who presides at the meeting, addresses it in favor of the resolution. He becomes the mouth-piece of the directors to justify their policies, and to explain in detail their operations. It is natural for him to conclude with the outlook for the future of the company. For the larger and important companies the addresses of the chairmen are

reported at length in the daily press and taken together they form a valuable guide to general business conditions in Great Britain.

Before putting the resolution to a vote, the members present are invited to ask questions or make such observations as they see fit upon the report. This is the signal for an impromptu discussion of company affairs which is very illuminating to the stockholders and occasionally very exciting.

There is, of course, nothing in this procedure which in any way affects the right of the majority to control the destinies of the corporation. But it furnishes a place for the expression of the public opinion. The opposition may be out-voted, but it is not silenced. It is articulate and this satisfies the spirit of fair play.

11. *Inspection of corporate books.*—Outside the right to attend meetings, and the right to receive the dividends declared by the management, the privileges of the individual stockholder are somewhat shadowy. The privilege of the stockholders to inspect the corporate books is a right incidental to that of control. By inspecting the books the stockholders are able to make this control intelligent and effective.

The books of a corporation are generally of two kinds—corporate and financial books. The former consist of the stock ledger, the transfer book and the minute books. Stockholders are generally given the right by statute peremptorily to demand to see these books, and to make abstracts and copies. If this right is denied, a stockholder may immediately sue the cor-

poration and the offending officers for the penalties prescribed by law, and may also get a mandatory injunction directing the officers to permit him to see the books. Ordinarily the stockholder has no such right, however, to see the financial books. If, in order to protect any of his prerogatives, it becomes necessary to examine the financial records, a court order must first be procured.[1]

The foregoing statement may be somewhat amplified with reference to Canadian law. It must first be stated generally that members of a corporation have no absolute right to inspect, whenever they think fit, all papers belonging to the aggregate body. It has been held in leading English cases that the privilege of inspection is confined to cases in which the member has in view some definite right or object of his own and to such documents as would tend to illustrate such right or object. The principle behind the restriction is that matters of internal economy and arrangement are not lightly to be interfered with. Apart from the cases mentioned, and without special enactment, a shareholder has no right to examine the minutes of directors' meetings, for the reason that it is not usually considered advisable to allow such examination. One can readily see that matters of

[1] In New York the statute provides that the penalties shall not be incurred by an officer who refuses inspection of the stockholders' ledger on the ground that the applicant has already made such an inspection in order to prepare a list of stockholders for sale. This is directly opposed to the English law which permits anybody—stockholder or outsider—to demand a copy of the names and addresses of the stockholders upon payment of a small fee that covers the cost of transcription.

great concern to the company might otherwise become public. Of the statutory right of inspection of certain books and documents the shareholder cannot be deprived. All the Canadian letters patent acts provide for the inspection by shareholders, during reasonable business hours of every ordinary business day, of certain books, and the making of extracts. These relate to the

(a) Company's letters patent and supplementary letters patent;

(b) Preliminary memorandum of agreement;

(c) By-laws of the company;

(d) Register of shareholders and directors;

(e) Stock register.

What the shareholder cannot get at under these provisions directly he may secure indirectly. Under several of the acts a certain proportion of the shareholders may apply to the courts for the appointment of an inspector to examine the company's affairs and management. The company may by resolution itself appoint such an inspector. The inspector has very wide powers. He can order the production of all the company's books and documents and examine upon oath the officers and agents of the company. He is there to get information not otherwise to be disclosed. His position is not judicial or quasi-judicial, and an action at law could not be based upon his report. His report does not bind even the company. In certain of the provinces his report is admissible in legal proceedings to show his opinion in

relation to any matter contained in the report. Under most of the acts an annual audit by accountants is compulsory, and this affords a means also of getting at the company's true financial position. The letters patent acts all provide that the directors must lay before the shareholders at or before the annual meeting a full statement of the affairs and financial position of the company. It must not be forgotten that directors are agents of the shareholders and appointed by them; and so even at common law, apart from statute, they are bound to keep proper and regular accounts of all transactions and at reasonable and suitable times to render accounts, without concealment, to the shareholders.

12. *Minorities.*—The theory of representation is the same in corporations as in political life. The directors are elected by the majority, but they represent all the stockholders. There is, however, this important difference, that in a legislative body the choice of members by districts will, unless the majority be overwhelming, give the minority a representation and a voice. In a corporation under the ordinary constitution of such bodies the minority is excluded.

The device of cumulative voting already described aims to remove this difficulty. Any considerable minority can by this method secure representation. The minority is not, of course, entitled to power, but it is a dangerous political expedient to deny it an influence. This is the idea which is back of all systems of cumulative voting.

Under normal circumstances the moral safeguard of minority interests is the fact that the directors will administer the corporation for the best interests of the whole. To reenforce this moral protection by any scheme of legal restraint would hamper the operation of the company's affairs, would defeat the free exercise of the will of the majority, and thus nullify the whole theory of a management thru chosen representatives. That unusual circumstances may arise in which minority stockholders are ruthlessly handled and their interests wholly disregarded is unfortunately true. Sometimes the acts of the governing majority by overstepping the limits of legal procedure may give rise to the intervention of the courts on the petition of stockholders, but this is a slender reliance of uncertain value.

13. *Rights of minorities.*—Courts of equity discourage corporations from washing their dirty linen in public. "If the directors are dishonest or inefficient put them out," says the court. But suppose the directors are kept in office by a majority that is milking the corporation for their own benefit. Such a situation frequently arises in subsidiary companies, in which the minority feel that their corporation is being used to pull the parent company's chestnuts out of the fire.

The line between downright fraud, on the one hand, and furthering legitimately the interests of the individual stockholder on the other hand, is difficult to draw. It has been held that a shareholder's vote to

dissolve a company is not invalid because the dissolution would terminate a contract that is beneficial to the corporation but onerous to himself. With the warning to the reader that fraud is always a difficult matter to prove, the subject will be dismissed with the following summary of the rights of a minority to prevent the majority from performing certain acts: [1]

(1) The right to prevent *ultra vires* acts;

(2) The right to restrain a bare majority from exercising a power, which, by statute, by charter-provision or by law, requires the assent of a larger majority —two-thirds or three quarters;

(3) The right to restrain the majority from committing fraud;

As was indicated above, the mere fact that a stockholder has a personal interest in a transaction is no reason why he should be prevented from exercising his right to vote in such a way as to further his personal interests. There is, however, a very definite line between this rule and the rule that a corporation cannot be deprived of its property unjustly and without proper consideration in return.

The principal difficulty arises in a case like this: A subsidiary is made to pay a dividend in order to provide income for the parent company, altho the dividend reduces the surplus and exhausts the company's working capital. In such a case, unless there were no

[1] Conflicts between minorities and majorities are considered here. Conflicts between stockholders and directors are treated in the next chapter.

bona fide surplus from which dividends could be declared, the minority would be without redress.

## REVIEW

As a stockholder you are called to the annual meeting of stockholders What regulates the place of meeting? What are the Canadian rules in this respect? When should you receive your notice?

Draw up this notice to stockholders for the meeting.

How would you draw up a waiver to the meeting?

Why are minutes the most important part of the meeting? What is their usual form?

How are minority stockholders protected?

# CHAPTER XIV

## DIRECTORS AND OFFICERS

1. *Theory of corporate management.*—The partnership, as we have seen, is a business institution in which each part of the management is as great as the whole, or to put it in another way, in which each member is a general agent of the concern. In the corporation this general agency is lodged in the board of directors. The power rests in the board and not in the aggregate of the directors, for directors must act in the board. The stockholders are entitled to demand that the directors put their heads together and give the corporation the benefit not alone of their individual judgment but of the collective judgment that grows out of intelligent discussion.

"Must directors direct?" is often asked. In spite of recent differences of opinion the remark made by Coke centuries ago still holds good on principle: "Governors out not to be idle as Cyphers in Algebra." A director is not liable for the acts of his co-directors. He is not bound to attend all the meetings and is not liable for what is done in his absence. But "gross non-attendance" is a breach of trust. When a director is compelled to leave the place where the meetings are held, the safest practice is to get a leave of

absence from the directors as a board. Directors cannot vote by proxy on the general principle that an agent cannot delegate his authority.

2. *Number and qualifications of directors.*—The number of directors is usually specified in the statute or charter and may run from three to twenty-one or even more. Frequently they are divided into classes, as in the following provision in the certificate of the United States Steel Corporation:

> The number of the directors of the Company shall be fixed from time to time by the by-laws; but the number, if fixed at more than three, shall be some multiple of three. The directors shall be classified with respect to the time for which they shall severally hold office by dividing them into three classes, each consisting of one-third of the whole number of the board of directors. The directors of the first class shall be elected for a term of one year; the directors of the second class for a term of two years; and the directors of the third class for a term of three years; and at each annual election the successors to the class of directors whose terms shall expire in that year shall be elected to hold office for the term of three years, so that the term of office of one class of directors shall expire in each year.

In most states directors must be stockholders; the actual ownership of one or three shares is generally sufficient. In New York and some other states the by-laws may provide that directors need not be stockholders. The directors are generally given power to fill vacancies for an unexpired term.

The Dominion Companies Act categorically provides that no person shall be elected a director unless he is a shareholder, owning stock absolutely in

his own right, and to the amount required by the by-laws of the company and not in arrear in respect of any call thereon. A minimum qualification of at least one share is required.

3. *Meetings and quorums.*—Directors are generally permitted to meet outside the state of incorporation. Meetings may be either regular or special. Notice of regular meetings is not usually required. What was said about stockholders' meetings generally applies to directors' meetings. Frequently a quorum is made to consist of less than a majority in order that business may be expedited. To prevent a majority of a bare quorum, which may be but a small proportion of the entire board, from dominating the company, the United States Steel Corporation has enacted a by-law which provides:

> Ten directors shall constitute a quorum for the transaction of business; but if at any meeting of the Board there be less than a quorum present, a majority of those present may adjourn the meeting from time to time.
>
> The affirmative vote of at least one-third of all the directors for the time being in office shall be necessary for the passage of any resolution.

4. *Powers of directors.*—As we have seen, matters which affect the entire property of the company at one time or that are provided for in the certificate of incorporation cannot be settled without the direct consent of the stockholders. All other questions usually can be decided by the board, tho even here the directors frequently protect themselves by referring im-

portant matters to the stockholders. It is an almost universal custom for the stockholders to ratify at their annual meeting the actions of the directors during the preceding year. During the course of the stockholders' meeting and while the ballots for the election of directors are being counted, the minutes of the directors' meetings are sometimes opened for the inspection of the stockholders for a reasonable time before the motion to ratify is made.

Directors usually are given power to pass by-laws that do not in any way affect by-laws already enacted by the stockholders.

It may be added that, by the various Canadian letters patent acts, power is expressly given to the directors to pass by-laws for certain purposes, and this has been held in effect to take away from the general body of shareholders the right to originate by-laws respecting those matters. The acts lay down that the affairs of a company are to be managed by a board of directors; hence no division of power between shareholders and directors is contemplated. Shareholders therefore cannot interfere in matters of internal management by initiating by-laws without the consent of the board. They must wait to pass upon by-laws submitted by the directors. On the other hand there is no express provision in the acts that shareholders are not to initiate by-laws tho that limitation flows naturally from what has been just said as to the power of the directors. It has been held that the recourse of shareholders who object to a by-law

which the directors persist in retaining is to wait for an annual general meeting and elect a new and more pliable board. At common law, it may be remarked, that is, in the absence of a contrary provision in the general act or the company's charter, the right to make by-laws for the management of the company is vested in the *whole* body of the shareholders. Under the English act, however, this common law right is preserved to the shareholders in that a majority of three-fourths of the shareholders may at any time alter the company's articles which are virtually by-laws, or oust an unwelcome board of directors.

5. *Committees.*—The same purpose that is sometimes accomplished by requiring only a small number of directors to constitute a quorum is achieved in large corporations by provision for committees. The executive committee usually possesses all the powers of the board during the intervals between meetings. In the United States Steel Corporation the executive committee is called the Finance Committee, whose constitution and powers are thus described in the by-laws:

*Finance Committee.*—The Board of Directors shall elect from the directors a Finance Committee, and shall designate for such committee a chairman, who shall continue to be chairman of the committee during the pleasure of the Board of Directors.

*Vacancies, How Filled.*—The Board of Directors shall fill vacancies in the Finance Committee by election from the directors; and at all times it shall be the duty of the Board of Directors to keep the membership of such committee full,

with due regard to the qualifications for such membership indicated in this Article of the By-Laws.

*Action of Committee to Be Reported to Board.*—All action by the Finance Committee shall be reported to the Board of Directors at the meeting next succeeding such action, and shall be subject to revision or alteration by the Board of Directors; provided, that no rights or acts of third parties shall be affected by any such revision or alteration.

*Rules of Procedure.*—The Finance Committee shall fix its own rules of proceeding, and shall meet where and as provided by such rules, or by resolution of the Board of Directors, but in every case the presence of at least four members shall be necessary to constitute a quorum.

In every case the affirmative vote of a majority of all of the members present at the meeting, shall be necessary to its adoption of any resolution.

*Membership.*—The Finance Committee shall consist of eight members, besides the chairman of the Board, who, by virtue of his office, shall be a member of the Finance Committee. So far as practicable, each of the eight elected members of the Finance Committee shall be a person of experience in matters of finance. Unless otherwise ordered by the Board of Directors, each elected member of the Finance Committee shall continue to be a member thereof until the expiration of his term of office as a director.

*Powers and Duties.*—The Finance Committee shall have special charge and control of all financial affairs of the Company. The president, vice-presidents, the general counsel, the treasurer, the controller and the secretary, and their respective officers shall be under the direct control and supervision of the Finance Committee, and of its chairman when the Committee is not in session.

During the intervals between the meetings of the Board of Directors, the Finance Committee shall possess, and may exercise, all the powers of the Board of Directors, in the management of all the affairs of the Company, including its purchase of property, and the execution of legal instruments

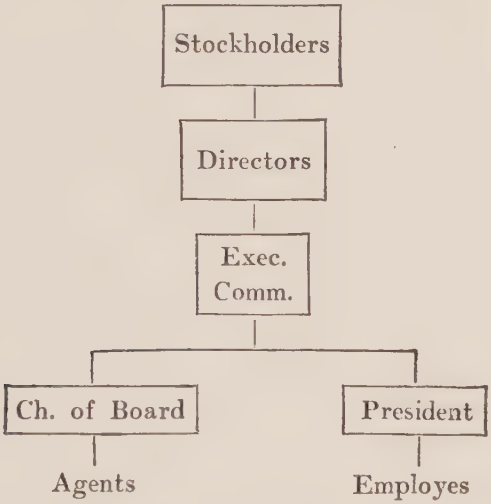
with or without the corporate seal in such manner as said committee shall deem to be best for the interest of the Company, in all cases in which specific directions shall not have been given by the Board of Directors.

*Powers of Chairman.*—During the intervals between the meetings of the Finance Committee, and subject to its review, the chairman of the Board and the chairman of the Finance Committee together, shall possess, and may exercise any of the powers of the committee, except as from time to time shall be otherwise provided by resolution of the Board of Directors.

6. *Officers, and how chosen.*—The officers of a large corporation consist of a chairman of the board, a president, several vice-presidents, a treasurer and assistants, a secretary and assistants, a controller, an auditor and general counsel. In most states some of the leading officers are chosen directly by the stockholders. In some corporations the subordinate officers are appointed by the chairman or president, tho these appointments are usually subject to confirmation by the board. Generally the officers are also directors, tho sometimes the subordinate officers are mere agents. In some states some of the officers must be residents of the state. This rule in Massachusetts, for example, applies to the clerk, i.e., to the secretary.

7. *Chairman of the board and president.*—In large companies undoubtedly the chairman of the board has more power than the president. He is usually the negotiating head of the company while the president is the operating head. Perhaps the distinction can

be made clear by calling one the director and the other the manager, both making up the administration. In chart form the administration of the United States Steel Corporation may be thus described:




In smaller companies the offices of president and chairman of the board are united in one person. He is the head of the corporation. "When an act is performed by him the presumption will be indulged that the act is legally done, and is binding upon the body." [1]

8. *Vice-presidents.*—It is an American tradition that a vice-president is a nonentity. He is a man with potential authority only, and American optimism refuses to believe that this potentiality will ever be-

[1] Smith vs. Smith, 62 Ill. 493.

come active. To be sure, the term of office for all officers of corporations is so short that little attention need be paid to the selection of a vice-president whose only power is to act in case of the death or resignation of the president.

In large corporations, vice-presidents are usually operating heads of departments, or plants and their selection is frequently the result of a process of selection from among the most able employes who move upward. In cases of consolidation, the vice-presidents, as operating heads of the several plants of a company, frequently hold their offices because they were presidents of the smaller companies that owned the plants before consolidation. Sometimes a twenty-five dollar a week clerk is a vice-president. Cases of this kind are found where numerous documents are required by law to be signed by the "president or vice-president." In such cases the duties and privileges of the vice-president are closely limited by the by-laws. In general, however, vice-presidents have no power except to act in case of the absence or disability of the president.

9. *Treasurer.*—The treasurer has charge of all the funds and securities of the company. He signs and indorses checks, bills of exchange, and with the president or vice-president, the certificates of stock. His actions are always subject to regulation by the board so that his own judgment is not used in the disbursement of funds, which as a matter of fact are usually paid out only on warrant from some other officer.

His assistants have immediate charge of the various funds.

10. *Secretary.*—The office of secretary of the Pennsylvania Railroad was described as follows by an officer of the corporation. The office as here described is typical of the secretary's position in any large company; the duties and responsibilities are clearly indicated.

The secretary's department is primarily under the supervision of the president, and yet receives instructions from and performs duties for, the executive heads of all of the other departments. . . . For the relief of the president, the nominations of all officers in the secretary's department must receive the approval of the first vice-president, and with the approval of the latter officer the secretary appoints all necessary employes in his department. The primary duties of the secretary are as an officer of the board, being responsible for a true record of the proceedings of the board, and the standing committees. The office of the secretary is included within the executive department because the secretary is the channel thru which the various officers are notified of the actions of the board pertaining to their departments, and of the execution of all contracts and other papers involving the interests of the company. The issue and transfer of the capital stock, and the books showing its ownership, are under his charge. He also is the custodian of the originals of the agreements and patents and other valuable documents, and takes charge of that portion of the machinery which gives notices of stockholders' meetings and elections, so that he is the agency thru which the corporate work of the company begins in each year. He also takes charge of the general office building, of the necessary repairs thereto, and the heating and lighting thereof. He is assisted by three assistant secretaries, an assistant to the secretary, and a stock transfer clerk.

11. *General counsel.*—From the same source comes the following account of what are generally considered the duties of the general counsel:

> Another officer embraced in the executive department is the general counsel, who is the head of the legal department and has charge of all the company litigation. In this responsible work he is brought into touch with every department and the heads of nearly every department find it essential to consult with him from time to time. The general counsel supervises the preparation of all contracts and bonds and furnishes opinions upon any subject referred to him by the president or board. His duties are far-reaching, and the wisdom of a competent legal adviser is an important element in the successful conduct of the company's business. He is aided by a general solicitor, two assistant general solicitors, located in the general office, and by district solicitors, residing in various cities along the company's lines.

The difference between the office of counsel and of solicitor, where such an office exists, is that the counsel acts in a consulting capacity whereas the solicitor has charge of active litigation.

12. *Controller.*—The controller is usually the principal officer in charge of the accounts. Sometimes his functions are increased to include some ordinarily assigned to the treasurer. Thus, he is frequently the officer upon whom the board relies to get information concerning probable future financial needs and he is then given some degree of power over the issue of the company's securities.

13. *Auditor.*—Where a company has an auditor and a controller the latter is more a financial officer than an accounting officer. He is interested in bud-

gets, whereas the auditor is interested merely in the accurate recording of transactions that have taken place. The accounting department of large corporations frequently requires elaborate organization, the various sub-departments of which are supervised by assistant or deputy auditors.

14. *General powers of officers.*—The powers of officers are given them by the by-laws. Tho the by-laws usually provide powers substantially similar to those outlined above, variations may occur. Where an act is performed by an officer who in most cases is clothed with power to perform such acts, the company will be bound unless the third party has actual notice of limitations on the officer's authority.

15. *Vacancies and removals.*—Vacancies may usually be filled by the board of directors. In the absence of by-law, charter or statutory provision, officers may not be removed at the pleasure of the board; without authorization from any of these sources, however, the directors may remove officers for good cause. Where removal is contemplated the officer should be duly charged and given an opportunity to clear himself of the accusations.

16. *Registrars and transfer agents.*—Such agents as registrar and transfer agents are ordinarily not considered officers of the corporation. They attend to the transfer of stock and see that no spurious certificates are issued. The transfer agent attends to the clerical work incident to the cancelation of old certificates and the issue of new ones. It is the duty

of the registrar to keep an account of the amount of stock outstanding and to prevent new certificates from being issued unless old ones of an equal par value are canceled. This rule does not, of course, apply where the corporation issues additional authorized stock.

In order that holders of stock may know that their certificates are not spurious both the registrar and transfer agent ordinarily countersign the certificate. Under the rules of the New York Stock Exchange both the transfer agent and registrar must be satisfactory to the stock exchange authorities. Moreover, while the transfer agent may be a clerk in the company, the registrar is required to be an independent trust company or other financial institution.

17. *Organization charts.*—In order to indicate clearly the duties of the officers as well as the proper coordination and subordination of their functions it is not unusual to draw an organization chart. The purpose of such charts is more fully explained in the Modern Business Text on "Plant Management" where several interesting examples are to be found. A simple illustration is shown on page 215 of this volume.

18. *Can directors and officers make contracts with themselves?*—This is an important question that frequently arises on account of the wide business connections of the executives of large corporations. Unfortunately the law is not uniform. Nearly all the states, however, agree that contracts in which directors or officers are personally interested are voidable

by the stockholders. If an action were brought by a stockholder to have such a contract set aside the burden would be placed on the director to show that the contract was beneficial to the company and that its terms were fair. It is always better for interested directors to take no part in the deliberation or actions of the board when a contract involving his personal interests is being discussed. The directors act in a fiduciary position. They must have an eye single to the interests of the company. But where the contract one makes with the company is fair and *intra vires*, there is no reason why, in the absence of a contrary provision, he should not as a shareholder vote to ratify the contract. In order to avoid doubts on the point, the disability of directors to contract with the company is now often waived by provisions in the charter or by-laws. Generally these enact that a director may contract with the company; that he shall not be liable to account for any profit provided that he discloses the nature of his interest at the directors' meeting at which the contract is decided upon; and that he shall not vote upon the acceptance of the contract. Many large corporations have passed by-laws similar to the following clause taken from the by-laws of the United States Steel Corporation:

> Inasmuch as the directors of this company are likely to be connected with other corporations with which from time to time this company must have business dealings, no contract or other transaction between this company and any other corporation shall be affected by the fact that direc-

tors of this company are interested in, or are directors or officers of, such other corporation, if, at the meeting of the board, or of the committee of this company, making, authorizing or confirming such contract or transaction, there shall be present a quorum of directors not so interested; and any director individually may be a party to, or may be interested in, any contract or transaction of this company, provided that such contract or transaction shall be approved or be ratified by the affirmative vote of at least three directors not so interested.

Section 10 of the Clayton Law prohibits railroads from having dealings in securities, supplies or other articles of commerce, or from making contracts for construction or maintenance of any kind, to the amount of more than $50,000 in the aggregate in any one year with

another corporation, firm, partnership or association when the said common carrier shall have upon its board of directors, or as its president, manager or as its purchasing or selling officer, or agent in the particular transaction, any person who is at the same time a director, manager, or purchasing or selling officer of, or who has any substantial interest in, such other corporation, firm, partnership or association, unless and except such purchases shall be made from, or such dealings shall be with, the bidder whose bid is the most favorable to such common carrier, to be ascertained by competitive bidding under regulations to be prescribed by rule or otherwise by the Interstate Commerce Commission.

The Dominion Railway Act specially provides that no person shall be capable of being a director of a railway who is interested in any contract with the company.

19. *Liabilities of officers.*—Persons holding office in a corporation ought to protect themselves by studying the laws of the state in which the corporation exists and in which they are acting. All kinds of fraudulent acts by corporate officers are usually made penal offenses by the statutes and sometimes acts which seem to be harmless are condemned. Thus in New York it is a misdemeanor, punishable by imprisonment for not more than six months, or by a fine not exceeding five thousand dollars, or by both, for a director to sell "short" the shares of his company or to purchase stock of the company on behalf of the company except out of surplus. In many states the directors are liable for selling stock below par.

The Canadian law as to the liability of directors may be briefly stated. The Dominion Winding-up Act states only well-known common law principles in declaring that a director is liable to the company where he has misapplied or retained in his own hands, or become liable or accountable for any moneys of the company, or been guilty of any misfeasance or breach of trust in relation to the company, and must repay or make compensation to the company for the loss. Directors are liable also for losses resulting from acts done by them as directors which are *ultra vires* the company, tho there may be no question as to their honesty and good intention. To pay dividends out of capital or when the company is insolvent is *ultra vires;* yet it has been held that the directors would

not in such a case be liable if they were misled by statements of officials in whom they had not placed undue confidence or trust, and provided they have not themselves been negligent. Directors must act in good faith and with reasonable care. Their private interests must be always subordinated. Broadly speaking, in order to make directors liable for breach of trust on the ground of negligence, it must be shown that they did not really exercise their judgment in the matter as trustees or agents for the company, and that as a result the company incurred a loss. They are not prima facie liable for the acts of agents or officials whom they appoint, unless these are notoriously unfit. Unless a director expressly or tacitly permits wrongful acts of co-directors he is not liable therefor. He is not liable for acts of co-directors committed without his knowledge at a meeting at which he was not present or after he left the meeting. If he knows that a breach of trust is contemplated by his co-directors, a mere protest by him will not free him; he must act positively as the situation may require, to prevent the act. Directors who are parties to the payment of a fictitious dividend to raise the price of the shares may be both civilly and criminally liable.

20. *Compensation of directors and officers.*—It is always prudent to let the stockholders fix the salaries of directors and officers. Directors as such are not entitled to pay, but the by-laws usually provide that they shall receive a fee for every meeting attended.

When the salaries of officers are being fixed by directors, the officer whose salary is in question should not participate in the discussion or vote. If he does he will be entitled to recover not the contract price but the fair value of his services. While directors have no inherent power to remove officers, they may do so indirectly by changing the by-laws to give them that power and by proceeding to remove the officer. If the officer is not guilty of a breach of trust, his contract for salary will be broken and he may sue for damages. In voting salaries it is usual, therefore, to provide that the salary shall be payable during incumbency in office.

## REVIEW

Can the directors of a company vote by proxy?

Can directors adopt a resolution by writing and signing it, without a meeting? If you were a director and did not approve of the resolution, what would you do if the board undertook to adopt it in this way?

Why is the chairman of the board usually a more important officer than the president?

Draw up the minutes of a directors' meeting in which all the officers mentioned in this chapter, all of whom are directors, are voted salaries.

To what extent must a director direct?

If the directors of a company were about to carry thru a contract with themselves that you thought was disadvantageous to the company, what would you, as a stockholder, do about it?

# CHAPTER XV

## INTERCORPORATE RELATIONS

1. *Causes of concentration.*—It is generally recognized that concentration in industry, the massing of great quantities of capital under a common ownership, has been the outstanding feature of the economic development of the United States since the Civil War. The Civil War itself contributed to this movement, since at that time men were trained for cooperative work and the demand for large supplies of manufactured goods began. The movement has been nurtured by the progress made in rapid communication and transportation. As units grew in size, the advantages of large-scale production became apparent and the wastes of competition were more and more realized. Finally, the experience of the promoters in forming combinations showed that profit could be made out of the process of combination, and we find combinations being formed for their own sake.

2. *Classes of combination.*—There will be occasion to study each kind of interbusiness organization that has been used in America in the last seventy-five years. It will be expedient first to describe each kind and to state to what extent it has been used. The legality of the organization may well be left to

a succeeding discussion that will embrace all the forms. During the period mentioned the following forms of interbusiness organization have been used: informal agreements, pools, trusts, consolidations, sales of entire operating assets, leases, stockholding, interlocking directorates and communities of interest.

3. *Various forms of combination illustrated in the history of one concern.*—Sometimes one combination [1] will be found to have had a history in which many of these relationships have existed.

In its brief career the National Cordage Company illustrated almost every economic and financial problem that could ordinarily present itself in the history of any industrial consolidation. On the economic side it showed the gradual concentration under one control of upward of ninety per cent of the American production in an industry where every condition favored competition. It dominated the market for the raw material and controlled, as well, the essential machinery used in the process of manufacture. To accomplish these ends every device was resorted to for creating a monopoly—the "gentlemen's agreement," the pool, the legal trust, the leased corporation, and the holding corporation.[2]

4. *Trade associations.*—Almost every trade has its association. Some of these exist chiefly for the benefit of the trade and some chiefly for the benefit of the individual members. The former are legal; the latter are liable to be illegal. Thus, the united efforts of gas companies to increase the consumption of gas

[1] The word, combination, hereafter will be used as a generic term to indicate any kind of interbusiness relation.

[2] Dewing's "Corporate Promotions and Reorganizations," p. 112.

is to be distinguished from cooperation in some other line of trade for the purpose of fixing and maintaining prices. The former kind of organizations have as their chief purpose the collection and dissemination of information regarding the trade; they accomplish their purpose by the use of trade-papers, conventions and the active work of paid secretaries. The illegal kind have used various devices. For example, a price list may be printed and observed without any definite agreement being made, altho with a tacit understanding that it will establish the price in the trade.

> Let me say that it is a general broad principle that if a certain price is felt to be a fair and right price, each one for himself feels that he ought to maintain that price and not vary from it to the detriment of his fellows, unless he should let them know, but without any agreement, express or implied, to that effect.[1]

Legitimate trade associations are easily converted into combinations to control the actions of the members. Wherever such control does become illegal it takes the form of some method of fixing prices or of restraining the manufacture and marketing of products. It is said that in certain lines of trade and industry, dealers and manufacturers held weekly meetings at which a definite understanding was reached regarding operation, output, prices, margins and similar matters.

In the anthracite coal, lumber, dairy products and

[1] Testimony of A. F. Huston in the investigation of the U. S. Steel Corporation.

many other industries, associations undertaking to exercise such powers have existed in the past, and it is charged that some exist at the present time. In many cases the associations normally have some legal, wise purpose. The objectionable features were at the most merely incidental and have for the greater part been eliminated. The continued existence and vigor of numberless associations attest the usefulness of such organizations, without these objectionable features.

5. *Importance, advantages and disadvantages of trade associations.*—It has been said, in regard to trade associations, that while they "are the least definite of the various combinations, they are probably the most important, because their scope is coextensive with the country and with its business." [1] To the businesses engaged, their chief advantage is in the secrecy that may surround their undertakings, in the simplicity of their procedure and in the fact that they exist not only for strictly private business purposes, but to help the trade generally. Their weakness lies in the fact that the right to control the constituents in the essential details that would make for the individual profit of the members, is not guaranteed by the law. In short they can advise but cannot control.

6. *Example of a national trade association.*—The following is a typical description of the work of a trade association—the National Commercial Gas Association. It is taken from a pamphlet issued by

1 Van Hise's "Concentration and Control," p. 64.

the association entitled "What can it do for you?" The same plan of work can be adopted in any line of business. It will be noticed that the various activities are carried on by committees. All of these committees act thru the agency of a paid secretary. Generally the scope of the work of an association such as this can best be determined by an examination of a list of the committees.

The important factors responsible for the formation of the National Commercial Gas Association were:

The need of more cordial relations between gas companies and manufacturers of gas appliances:

The need of a common display of manufacturers' goods, for comparison and study by the commercial gas man;

But above all:

The need of a national organization to act as a clearing-house for the exchange of ideas among the commercial men of the industry.

Prior to the year 1905 there had been little concerted effort to appeal to the public by rendering up-to-date service, or to stimulate the purchase of only efficient and standard gas appliances. Some of the larger companies, it is true, had begun to work on this basis. But these were sporadic efforts and did not represent a general policy.

The pioneers in the movement saw the necessity of such an organization as the National Commercial Gas Association to act as the center in promoting plans which made for standard practice, to stimulate interest in the commercial side of the business, and to help gas companies extend their service greatly by educating gas company employes along broad, up-to-date lines.

With such a large, well-defined policy for bettering conditions, it is not strange that the Association received support from the very beginning from those who understood the possibilities latent in an organization of this kind. It is

true, as it is always true of new enterprises, good, bad or indifferent, that there was a certain measure of opposition. This, however, did not prevail, and the Association soon began to make its influence felt.

We began with an individual membership of thirteen. We now have 2,700 members, representing more than 450 gas companies and 200 manufacturers of appliances. This growth has been a natural one, year by year. Most important of all, a majority of the individuals retain their membership year after year.

To increase further the scope of the Association's work, a company membership was added in 1912. It includes at the present time 300 members, 185 of whom are gas companies, the balance manufacturers of gas appliances.

The Association has held annual conventions and exhibits of gas appliances in New York, Chicago, Philadelphia, Boston, Minneapolis, Denver and Atlanta. Every one of these conventions has been largely attended and, what is even more gratifying, every year sees an increasing interest and a more widely representative attendance.

In order to arouse a further interest in the work of the Association, various companies have formed local sections of the employes who are members of the association. These sections really are local clubs. They hold regular monthly meetings to read and discuss papers, to mingle socially and to see and take part in entertainments. The result has been the establishment of friendly and harmonious relations among members of the various departments of the company.

The *Monthly Bulletin* of the Association, which began as a modest four-page folder, has gradually increased to a monthly average of 84 pages. This official organ of the Association is full of commercial information and keeps the members posted on the progress made in every line of commercial activity.

The Annual Proceedings, which are sent to all members, are a full report of the year's activities, including the reports of all committees, all the papers presented, with their accompanying discussions, and much miscellaneous, valuable

data and information. A complete list of all members is also included.

The Association has published from time to time booklets for gas companies to distribute locally. A notable example has been the "Gas Equipment of the Home," of which 80,000 copies have been distributed during the past year. It is planned to continue and broaden this branch of the Association's activities.

During the year July, 1914, to June, 1915, the Association conducted a national advertising campaign thru the medium of national magazines, to create a wider interest in the use of gas for lighting, heating and cooking, and to establish a more complete understanding between the gas business and the public. There is no doubt that this campaign has been of incalculable direct benefit to the industry, or that it has stimulated companies generally to realize the importance of proper and timely publicity.

The most important activity of the Association during the past four years has been its educational work for gas company employes.

The Association Headquarters are looked to by companies as a clearing-house for commercial gas information, as is evidenced by the abundance and scope of the inquiries received.

Today the industrial fuel field is one with enormous possibilities, and should be given the most serious consideration. The Association plans to add to the Headquarters' staff an industrial fuel expert, whose services will be at the disposal of all member companies. The value to a progressive company of such a man, with the vast store of data and information which he will have at his command, cannot be overestimated.

The Industrial Fuel Course, of the new educational program, will approach the same subject from a different angle. Finally, the Industrial Fuel Committee is preparing now, and will have ready for distribution this year, a complete series of pamphlets covering the practical possibilities of gas in the various industries. These papers will deal with

the nature of the different processes and the appliances to be used. Tests and cost data in addition will make this series a valuable reference work for the gas man.

Another committee is now preparing a Salesman's Handbook—a long-felt want with gas salesmen. The plans embrace a complete data or reference book of authoritative information, including a description of the general types of gas appliances in common use, the proper method of installing each appliance and the conditions under which it may properly be used.

This service will also include a list of appliance manufacturers and trade names, cross-indexed by the names of appliances. The handbook will be kept up-to-date, and additional sheets will be furnished at regular intervals.

The Window-Dressing Committee plans to supply member companies with a regular window-dressing service. Part of this plan is the proposed employment of a window-decorating expert, who will be a member of the Association's permanent staff and have facilities at his disposal for creating designs to fit any situation. This promises to be a service of great value to all companies.

The National Advertising Committee is supplying companies with a regular cooperative advertising service. It is the intention to cover in the future not only the newspaper field, but that of general miscellaneous advertising as well, by sending out finished samples of circular letters, post cards and folder work. Under this plan, companies pay for only the service of which they actually make use; and in addition, the price is much smaller than that for which a single company could prepare its own material.

In a word, the Association is in a position to render gas companies valuable service. Its members, among the most active and progressive commercial gas men in the country, are giving their time and drawing on their experience, to promote the objects of the Association, and hence the welfare of the industry generally.

The annual dues of individual members are $5.00 and carry with them the privilege of participation in any of the

Association's activities, service on committees and receipt of all the literature prepared by the organization. Gas company members' dues are based upon the population served, as follows:

| | |
|---|---|
| Companies serving less than 10,000 population | $10.00 |
| Companies serving 10,000 to 25,000 population | 15.00 |
| Companies serving over 25,000, to 50,000 population | 20.00 |
| Companies serving over 50,000 to 100,000 population | 25.00 |
| Companies serving over 100,000 population | 50.00 |
| Foreign companies | 25.00 |
| Holding companies (in the event underlying companies are in membership) | 50.00 |
| Manufacturing companies | 25.00 |

Annual dues of gas-appliance manufacturers for company membership are $25.00. Only company members have the privilege of displaying at the annual gas-appliance exhibits of the Association.

The National Commercial Gas Association stands ready to help every gas man and every gas company. Every individual interested in the commercial development of the business is invited to become a member. Every company in the business is urged to form a local or company section, to give its employes an opportunity for a closer acquaintance with one another, a more intimate knowledge of the policy and work of the company, and a truer stimulus for their everyday tasks.

7. *Example of local retailers' association.*—An interesting example of a retailers' association is furnished by the Retail Grocers' Association of Philadelphia.[1] Competition among grocers and deli-

[1] The following facts about this association are taken from an article entitled, "Cooperation Among Grocers in Philadelphia," by E. M. Patterson, in the *American Economic Review*, Vol. V, pp. 279–291.

catessen-store grocers and other retailers of provisions in Philadelphia is very severe. It was estimated that the average income of the proprietor of such an establishment in 1911 was $640 per year after all expenses of the business had been met. In order to increase the margin of profit the Retail Grocers' Association has resorted to various devices, some of which have been successful; others, however, have been only partially successful, and some have been wholly unsuccessful.

In 1915 the association consisted of 458 members out of the 6,200 grocers in the city. All applications for entrance are passed upon by a committee, and each new member is compelled to purchase two shares of stock, at $100 each, in the Girard Grocery Company—a jobbing corporation owned and controlled by the association—in addition to paying an admission fee of $25 and one quarter's dues, amounting to $1.50. The jobbing corporation is owned entirely by members of the association, but it deals with outside grocers as well as with members. The activities of the association have resulted in the establishment of two building-and-loan associations, a horse-insurance fund, a fire insurance fund, a death benefit fund and a monthly magazine.

8. *Successful and unsuccessful undertakings of local association.*—The Retail Grocers' Association of Philadelphia has demonstrated that any undertakings which do not confer a direct benefit upon the individual members are unsuccessful. Such, at any

rate, was the outcome of the association's attempt to accomplish the following objects: (1) to maintain an employment bureau, free to both clerks and employers; (2) to carry out a plan of cooperative advertising; (3) to frustrate the plan of the regular brokers to sell directly to consumers; and (4) to bring the Standard Oil Company to terms by organizing the West Virginia Refining Company.

The principle applies to individual groups of interest as well as to individual persons. This was clearly seen when the Retail Grocers' Association attempted to enlist the manufacturers' aid in strangling the chain stores. Their support of the manufacturers could not be won because there were about 600 chain stores in the city, while the association had but 750 members.

The association has also shown that any activity which would necessitate the revelation even to an association secretary, of such illuminating facts of the business as those contained in the accounts and bills receivable can hardly be expected to be successful. The same may be said of any activity that subjects the individual members to a general association policy instead of to a personal policy in matters which may easily alienate customers, as, for instance, the collection of accounts.

The association has proved that no local organization can meet and combat any trade policy which has national vogue, or which is used by the powerful manufacturers. The use of the trading stamp is a

case in point. The manufacturers of "Force," for instance, adopted a trading-stamp plan that practically compelled the retailers to follow suit and use the Green Trading Stamps.

The reason why the Retail Grocers' Association has been able to obtain at least partial success is that the interest of the association has been in accord with, rather than run counter to, such forces as public opinion and manufacturers' interests. Thus the pure-food bills were passed, and the handling of groceries by large department stores was blocked, partly thru the aid of manufacturers.

The association's attempt to control prices directly has been unsuccessful largely because it feared price-cutters and the courts, as well as on account of the necessity of a signed agreement. Control of prices by indirect methods, however, has proved partially successful, in a great measure because of the cooperation of the manufacturers. The plan adopted was to have the manufacturers fix the retail prices.

The unqualified success of the association in certain fields has been attained because (1) the members have presented a united front against common rivals, and (2) the association has disarmed these rivals by adopting the legal and business organization of the latter. The case most illustrative of the association's success is its victory over the jobbers. In 1899 the organization purchased the so-called Buyers' Exchange. In 1903 the exchange, in purchasing for all the members, ordered goods in such quantities as

to be able to buy directly from the manufacturers. The jobbers brought pressure upon the manufacturers to remove the association from their list, and some of them yielded. The association solved the problem, however, by selling the exchange to the Girard Grocery Company, a corporation organized to do a jobbing business, and thru it the members of the association were able to do their purchasing on practically the same terms as before.

9. *Pools.*—It would be beyond the scope of this book to attempt a complete classification and description of pools.[1] Many formal pooling agreements were made between 1879 and 1887. These formal agreements gave the constituent corporations complete possession and control of their separate properties. They controlled the amount of output, divided the markets, according to either territory or quantity, or in some other way pooled the profits. A better idea can be obtained of their general nature from a description of their method of business.

10. *Steel pools.*—In 1887 the steel-rail pool was formed. Some of its operations were guided by an express agreement, some according to outside arrangements. The agreement created a Board of Control of three men who, under certain restrictions, allotted the steel-rail output of the country to the constituents, in a proportion running from 1.4 per cent to 13.5 per cent. There was a penalty of $1.50 to

[1] See "Classification of Pools and Associations," by W. I. Stevens in *The American Economic Review*, Vol. III, p. 545.

$2.50 for each ton produced in excess of the allotted amount. This last provision was not stated in the agreement, nor was the schedule of prices, tho there is little doubt that such a schedule was fixed and generally adhered to. The pool finally broke up because, while the price schedule was observed, it was found that the largest company was furnishing to its customers, without extra charge, the spikes needed to fasten the rails to the ties.

11. *Addyston pipe pool.*—The pool which was the object of the first successful prosecution of an industrial combination under the Sherman Anti-Trust Act —the Addyston pipe pool—is described by Haney as follows:[1]

> The avowed object of the pool was to regulate prices, and its chief means lay in a pooling of the incomes, which will be described briefly below; but half the story hangs upon its division of territory. In the first place, the United States was divided into two great territories, known as "pay territory" and "free territory." It must not be supposed that pipe was free in the latter region. It was merely the territory in which the members of the pool were free to sell on such terms as they chose, without paying anything into the pool. "Pay territory," on the other hand, embraced the states in which, for every sale made, a bonus had to be paid into the pool. There were thirty-six such states, Virginia and her sister commonwealths to the north and east being "free." The fixed bonuses ran from $1 to $4 per ton according to the state.
>
> Besides this territorial arrangement a system of "reserved cities" was evolved. Thus a resolution of 1894 provided that "The Addyston Pipe and Steel Company shall

[1] Haney, "Business Organization and Combination," pp. 172–3.

handle the business of the gas and water companies of Cincinnati, Ohio, Covington and Newport, and pay the bonus heretofore mentioned, and the balance of the parties to this agreement shall bid on such work at such reasonable prices as they shall dictate. . . . Dennis Long and Company of Louisville, Kentucky, shall handle Louisville, Kentucky, Jeffersonville, Indiana, and New Albany, Indiana, furnishing all the pipe for Gas and Water works in above-named cities," and so on for each member. Clearly a prominent feature of this agreement was a pooling of the market.

12. *Advantages of pools.*—It must not be thought, because old pooling agreements have been discussed here, that pools do not exist today. They do exist in spite of all legal and political attempts to prevent them. That they have had important advantages for those engaged in them cannot be denied. They are simple, quickly formed, and involve no great accumulation of capital; they therefore do not place the industry under the burden of paying income on huge capital liabilities representing promoters' profits.

Frequently they have fixed prices, not exorbitantly high, but simply high enough to insure sufficient profit to prevent the extinction of invested capital. By the influence of pools marketing costs have been reduced; cooperation in the granting of credit has diminished losses from bad debts; and cross freights have been saved.

13. *Disadvantages of the pool.*—The chief disadvantage of the pools is their instability. As will be shown, they are generally illegal and therefore lack the power to compel obedience to the contractual obli-

gations undertaken by the members of the pool. Moreover, they have in some cases handicapped ambition and encouraged deceit and falsehood.

14. *Trusts.*—Because pools were unstable, the voting trust agreement was adopted and was applied to competing companies each of which selected the same group of trustees. The method was originated in 1879 by the general solicitor for the Standard Oil Company; he perfected it in 1882. Soon afterward trusts were formed in the whiskey, sugar, cotton-seed oil, linseed-oil and white-lead industries.

15. *A typical legal trust.*[1]—It will be well to describe very briefly the largest legal trust that has ever come into existence in the United States—the Standard Oil trust.

The trust agreement was dated January 2, 1882, and included three classes of parties. In the first class were all the stockholders and members of the so-called Standard Alliance and Association of Refiners, in which the members were stockholders of the several companies that up to this time had controlled the oil business. This class also included members of certain other companies outside the alliance.

The second class included all the more important officers and stockholders of the various companies. In the third class were certain of the stockholders and members of other corporations and partnerships.

1 The use of the word legal does not mean that the trust did not break the law; it was legal in the sense that the trust was a device known to the law for accomplishing the purpose in view. In other words, the device was a legal expedient and not a business expedient.

The agreement provided for the admission of new companies and for the formation, whenever possible and advisable, of a branch of the Standard Oil Company in any state or territory in the Union. All the parties were to transfer all their property to the Standard Oil companies in the several states, and to receive in return stock equal, at par value, to the appraised value of the properties so transferred. This stock was then to be transferred to the trustees, and no additional issues of stock could be made by the companies to any one except the trustees.

The trustees were to deliver to the owners of the properties trust certificates equal in amount to the amount of stock which the trustees had received for the several properties. As the trustees collected dividends from the several companies they were to disburse the amounts to the holders of the trust certificates. In March, 1892, the Ohio courts compelled the dissolution of the Standard Oil trust.

16. *Community of interest.*—The most recent form of interbusiness relation is that represented by the so-called community of interest plan. Control rests primarily in interlocking directorates, but it is exercised in many other ways; there is, for example, the control of banking facilities, as well as the control of important customers. A large community of interest is found in the water-power development companies, many of which are controlled by the General Electric Company of New York thru direct ownership of the stock of many companies by itself and

by its subsidiaries, thru interlocking directorates with only a minority stock control, and thru interlocking directorates without stock ownership. The extent of this community of interest is described in a special report of the Commissioner of Corporations as follows:

The General Electric companies have a very extensive influence in the water-power business of the United States. As shown in the table on page 15, the total water-power, developed and under construction, of the companies involved in these interests is almost 940,000 h.p. Adding to this 62,500 h.p. developed by the Canadian Niagara Power Company, on the Canadian side of Niagara Falls, and sold in the United States, makes a grand total of over 1,000,000 h.p., developed and under construction, coming under the influence of the General Electric Company. The companies included in the General Electric group own water-power in 18 states. These states have 2,325,757 "commercial" horsepower, developed and under construction. Of this, 40 per cent is in the General Electric group described. In Pennsylvania, they control nearly 80 per cent, in Colorado 72 per cent, in New Hampshire 61 per cent, in Oregon 58 per cent, and in Washington 55 per cent.

In addition to their developed power, these companies own 641,000 h.p. undeveloped. There is, therefore, total water power in the United States of at least 1,580,000 h.p. coming under the General Electric group. These figures assume a much higher significance when it is understood that they generally represent not only the best, but in some instances all, the water-power practically available in the respective communities. It should be repeated, however, that the General Electric companies do not have complete control of all these concerns, but that in the case of many they simply have a voice in their management thru representation on directorates.

17. *Types of community of interest.*—The reader can readily see that there are different types of community of interest. One of these may be spoken of as community in direction only, the other as community in ownership. In the previous case the community of ownership was illustrated. In the other type an officer or director of one corporation is put on the directorate of another corporation. This may be true even without the existence of an interholding of stock sufficient to create a community of ownership. There is no question, however, that the community will be more positive if the directorate is based upon a considerable mutual holding by the corporations of each others' stocks.

Some community-of-interest organizations consist in an interlocking body of stockholders or directors binding together interrelated corporations no one of which is decidedly dominate.

In a special report on intercorporate relations prepared by the Division of Statistics of the Interstate Commission the interrailway community of interests is described, embracing many types. Besides the joint holdings of the Pennsylvania and New York Central lines in the Baltimore and Ohio, and the Chesapeake & Ohio, the Lehigh Valley was brought into the "community" thru holdings of its stock by the Erie, the Reading, the Lake Shore, the Central of New Jersey and the Lackawanna. This report concludes:

> The extraordinary concentration of railway interests shown in the situation in the Middle Atlantic seaboard would

lead to the conclusion, that, so far as this group of railways is concerned, competition has been practically eliminated.

18. *Control of an industry thru special practices.*—Competition among various members of an industry may be thwarted in various ways about to be described. A patent right belonging to one competitor or a group of patents belonging to several competitors may be turned over to an association which will give a license to the various members. The duration of the license will depend upon the observance of certain regulations, in regard to such things as the amount of output and the price to retailers.

A complete catalog of special practices of this kind in the transportation field has been drawn up by the Committee on the Merchant Marine and Fisheries, as follows:

> A railroad obtains control of a water line or canal and fails to maintain the efficiency of the same, thus making water transportation so expensive as to eliminate competition, or fixes rates so high as to preclude its use, or abandons the property.
>
> A railroad charters space from a competing water line, altho not using it, thus depriving shippers of space and making them dissatisfied with the water-line service.
>
> A railroad or its controlled water line or terminal company holds all the available docks and shedded piers, and refuses access to an independent line for the purpose of discharging and receiving cargo, or allows access only upon payment of unreasonable charges. The independent line is thus required to unload at some other dock and team the goods to and from the railroad station.
>
> A railroad or its controlled water line owns the available

water frontage, which it refuses to utilize, at the same time refusing to release the same by sale or otherwise.

A railway-water line or large all-water line cuts rates unduly (either by putting "fighting ships" in the trade or by having its regular boats quote unremunerative rates) and, when competition has been destroyed, advances the rates even higher than they had been originally. While cutting rates the larger company recoups itself out of rates at non-competitive points, or on thru business secured from railroads on a favorable basis.

Railroads manipulate rates so as to make the differential between their all-water, all-rail, and rail-water routes ineffectual as far as water transportation is concerned. The only inducement to use the water route is economy, and if the differential between the rail-and-water rates is made such as to just counterbalance the disadvantages of the water route, the railroads will secure the business because, all things considered, their service is preferred.

Water lines make contracts with shippers whereby rebates or special rates are granted if the shipper transports his entire product by a given line. Such contracts with important shippers greatly handicap independent lines in getting sufficient freight, especially if the contracting line spreads the report that the independent line will be allowed to remain in business only a short time. The important shippers, their business once obtained, can be held in line or disciplined.

Large established water lines bring influence to bear on marine insurance underwriters whereby the independent line can secure only a less favorable rate, having due regard for the class of vessel, than its large and well-established competitors, thus forcing the independent carrier to equalize the extra cost of insurance in its rates to shippers.

Railroads or steamship combinations can allow competing lines a certain amount of freight with the implied knowledge on the part of the competing line that the railway or steamship combination possesses the power to withdraw this allotted freight if the competing line shows aggressiveness or is unwilling to conform to the line of conduct desired. Often

valuable season contracts are made with independent water lines, which these lines do not wish to lose by competing for freight.

Railroads may divert bulk traffic from watercourses by granting special commodity rates "in transit," such as "milling in transit" and "compressing in transit."

Railroads can give access to docks to preferred water lines with which they have special arrangements, thus forcing shippers by other water lines to pay a series of charges for switching, docking, and unloading, and putting them to much inconvenience. In effect, it means that the shipper who wishes the proper service must use the water line preferred by the railroad.

Railroads may refuse to issue thru bills of lading except to favored lines, thus preventing independent lines from obtaining transfer traffic. To deprive an independent line of the advantages accruing from a joint-rate arrangement with railroads, places the line in a defenseless position as compared with competing lines not thus handicapped. Without such an arrangement the independent line cannot secure interior freight and is limited largely to port-to-port traffic, which is too small in volume to support the line. On the other hand, the water line having the prorating arrangement can cut rates to an unremunerative basis on the port-to-port traffic, thereby eliminating its less fortunate competitor, and recoup its losses in large measure out of the profits secured on the thru business.

Railroads charge more for the local haul from Buffalo to seaboard points, for example, on grain that is taken to Buffalo by boat than the proportionate share of the all-rail haul from Chicago to the seaboard, thus making the thru rail-water route unprofitable as compared with the all-rail route. The local rate for the eastern rail haul is so high as to leave little to the independent water carrier for its local lake haul.

Railroads can greatly reduce rates between those points only where they are competing with an independent water carrier. Since most of the traffic of a large railroad sys-

tem is free from water competition, it can afford to lower the rates on the competitive traffic to an unremunerative basis without appreciably affecting the earnings of its entire system.[1]

## REVIEW

Is a trade association legally a partnership, a joint stock company or a voluntary association?

Judging from the experience of the Retail Grocers' Association of Philadelphia, what activities would you suggest that an association of local cigar stores might undertake?

What is the difference between a pool and a community of interests?

Which of the special practices mentioned in this chapter might be used by the members of any manufacturing industry in this country?

[1] See Report of the Committee on the Investigation of Shipping Combinations, under H. Res. 587, Vol. IV, pp. 410–412.

# CHAPTER XVI

## CONSOLIDATIONS, SALES AND LEASES OF ASSETS

1. *Meaning of term consolidation.*—The word consolidation has been used indiscriminately to indicate all processes of forming intercorporate relations. Careful writers, however, restrict its use to describe a complete fusion of corporations under the provisions of some statute. This fusion may result in a company with a name similar to that of one of the constituents. In that case the process is called merger. If the consolidated company adopts a new name, the process is called amalgamation. The processes of consolidating and the legal effect they offer are practically the same whether an old name or a new name be used.

"Amalgamation" is the English equivalent of the American term "consolidation." It has been held in leading English cases that the term "amalgamation" has no technical legal meaning, and even as a commercial term bears no definite meaning. "To constitute an amalgamation," said Justice Buckley, in a notable judgment, "you must have the rolling, somehow or other, of two concerns into one. You must weld two things together and arrive at an amalgam—a blending of two undertakings. It does not neces-

sarily follow that the whole of the two undertakings should pass—substantially they must pass—nor need all the corporations be parties. The difference between reconstruction and merger is, that in the latter is involved the blending of two concerns one with the other, and not merely the continuance of one concern." "Amalgamation," and "merger" mean the same thing, it is said also, but the former term serves more properly to describe a process of fusion, and the latter to describe the process of absorption.

2. *Statutory authority necessary.*—The state is jealous of its creature and will not permit it without the state's consent to do anything that affects its corporate existence. It would be contrary to the common law, then, for two corporations to consolidate unless the state's consent be first obtained. This consent is now generally given in the General Corporation Act of the individual state, but is restricted to such corporations as will not in the process of consolidation violate any of the other laws of the state, chiefly the anti-trust laws. Moreover, the companies that can consolidate must generally be in the same line of business in order that the consolidated company may not reach out into all activities of life and design to become more powerful than the state. Thus if company X has powers A B C and company Y has powers A and B, the two cannot consolidate. This was the situation when the United States Leather Company and the Central Leather Company tried

to merge in 1906. In 1909, however, the Central Leather Company changed its powers and then acquired the stock of the United States Leather Company.[1]

Statutes usually restrict consolidation to cases where consolidation will do the constituents some good. Thus, unconnected railroads are not permitted to consolidate. In New Jersey, the whole question is placed before the Public Utilities Commission to whom all applications for the right to consolidate, whether by public service companies or by industrials, must be made.

3. *Nature of consolidation.*—Consolidation results in the complete fusion of the constituent companies. The number of powers and obligations remain the same as before the consolidation.

4. *Method of consolidation.*—The statutes usually prescribe four steps in the consolidation of several companies: (1) an agreement by the directors of the several companies upon the terms of consolidation; (2) submission of the proposition to the stockholders, two-thirds of whom in each corporation must consent; (3) the filing of the certificate of agreement in the proper public office; (4) exchange of certificates of stock of the old companies for those of the new com-

[1] After the first attempt at merger the idea of consolidation was abandoned and the second arrangement spoken of above was in effect, the organization of the Central Leather Company into a holding company. The U. S. Leather Company as a separate corporation, is still in existence as a selling company in order that the value of the name in the trade may not be lost.

pany. In some states the agreement of consolidation must be published in newspapers once a week for several weeks.

5. *Effect of consolidation upon the old corporations.*—If an attempt at consolidation does not conform to the statute, any stockholder may bring an action to prevent the consolidation and, of course, the state may bring a proper action to preserve its own rights. If, however, the consolidation conforms to the statute, the stockholders become stockholders in the new company tho in many states, including New York and New Jersey, non-consenting stockholders may apply to a court to have a commission appointed to appraise the value of their stock. The consolidated companies are then required to pay the costs of the court proceeding and the fees of the commissioners, and to purchase the stock of the disgruntled stockholders at the price set by the appraisers.

After the consolidation has been completed the old corporation ceases to exist and all its property becomes vested, without further transfer, in the name of the consolidated company. Thus it is unnecessary for the consolidated company to receive a deed of real estate from the constituent companies.

6. *Effect of consolidation upon the status of creditors.*—Creditors, it will be seen, are not consulted in the process of consolidation. It is a well established principle, however, that the rights of a creditor cannot be affected by actions of the debtor. For that reason the new company assumes all the obligations

and duties of the constituents and if the consolidated company fails, the creditors of the constituent companies may pursue such assets of the constituent companies as can be identified. Of course, mortgages placed on properties of constituents, are not affected any more than they would be if a company which had placed a mortgage on its property sold out. While under the rules just stated, unsecured creditors of the constituent companies would seem to have a first equitable claim against the separate properties of the constituent companies, the fact that this claim existed would not prevent the consolidated company from placing a mortgage on its property that would have priority over the claims of the unsecured creditors. This rule does not injure the right of the unsecured creditors of the constituent companies since the constituent companies themselves might have mortgaged the property even tho they had incurred unsecured debts which were outstanding.

7. *Amalgamation of American Tobacco Company.* —An example of an amalgamation is presented in the case of the American Tobacco Company. This amalgamation was consummated in 1904. This company, it will be remembered, was dissolved by decree of the United States Supreme Court in 1911.

In 1901 the Consolidated Tobacco Company was formed to hold the controlling interests of the American and Continental Tobacco Companies. Nearly all of the common stock of these companies was exchanged for four per cent bonds of the Consolidated

Tobacco Company secured by a deposit of the stock. For three reasons it was decided to change this holding company arrangement into a complete consolidation. In the first place, holding companies, when they control subsidiaries that have a dominating position in an industry, had been condemned by the decision of the Supreme Court of the United States in the Northern Securities case. To abandon this legal organization might strengthen the position of the combination in case it were attacked under the anti-trust laws. In the second place the four per cent bonds exchanged for common stock of the subsidiaries were largely held by the directors of the consolidated company who were compelled to stand by while the market value of these bonds dropped to 50. Some arrangement had to be made to strengthen their position. In the third place it was desired to concentrate control by providing a class of non-voting preferred stock which was to be held largely by outsiders. The inner circle was to receive a small amount of stock carrying the voting power. The merger agreement provided for the consolidation of the three companies into "The American Tobacco Company" with a board of twenty-eight members all of whom had been directors or officers of the amalgamated companies. The general arrangement was "that the outstanding common stock of the Consolidated, together with the small amount of common stock of the American and Continental which was held by individuals, should be exchanged for equal amounts of common stock in

the new or merged company and thereby retired; that the common stock of the American and Continental companies which was held by the Consolidated, as well as intercompany holdings of Continental preferred stock, should be canceled; that the preferred stocks of the American and Continental companies held by the public should be exchanged for first-lien bonds of the new company and retired and that the bonds of the Consolidated Tobacco Company, which had previously been issued in exchange for the common stock of the American and Continental companies should be converted partly into second-lien bonds and partly into preferred stock of the reorganized American Tobacco Company." [1]

The securities of the several companies were exchanged as follows: [2]

| *Former securities* | *New securities of American Tobacco Co.* |
|---|---|
| American Tobacco Co.: | |
| Common stock, for two $50 shares | $100 common stock. |
| Preferred stock, 8 per cent cumulative, for each $100 share | $133.33⅓ 6 per cent first lien bonds. |
| Continental Tobacco Co.: | |
| Common stock, for each $100 share | $100 common stock. |
| Preferred stock, 7 per cent non-cumulative for each $100 share | $116.66⅔ 6 per cent first lien bonds. |
| Consolidated Tobacco Co.: | |
| Common stock, for each $100 share | $100 common stock. |
| Bonds, 4 per cent for each $100 | $50 4 per cent second lien bonds; $50 6 per cent cumulative preferred stock. |

[1] From Report of the Commissioner of Corporations on the Tobacco Industry, Part I, p. 129.

[2] Idem, page 135.

8. *Advantages of consolidation.*—Complete legal consolidation presents certain advantages over the other forms of intercorporate relations. In the first place it creates a simple organization that makes uniform management possible. Where corporations are brought together under a holding company scheme, taxes and other burdens imposed by the state are considerable. As the income passes from one corporation to another the subsidiaries must pay the Federal income tax. Each subsidiary keeping its own separate existence must render the necessary reports to the various departments of the Government. When a public utility company has subsidiaries in several states, the number of general and special reports to be submitted to the Federal and state authorities runs into the hundreds every year. Moreover, a system of subsidiary companies offers opportunity for manipulation, since it is possible to hide the true financial condition of subsidiaries. In the consolidated company all the financial accounts are plainly set forth in the balance sheet and the income and profit and loss statements so that juggling of the accounts can hardly escape the charge of downright false statement. Finally, as in the case of the American Tobacco Company, consolidation often offers an opportunity to reorganize a number of relatively small companies whose financial plans consist of an illogical jumble of stocks and bonds. The recent consolidation of the New York Central and Hudson River Railroad and the Lake Shore and Michigan Southern Railroad

Company with its subsidiaries into the New York Central Railroad Company is a case in point. The reasons for the consolidation were briefly stated by the Interstate Commerce Commission as follows:

> The New York Central states that the proportion of bonds to stock of the Lake Shore approaches closely the limit of separate and economic financing of that property ($150,000,000 of bonds to $50,000,000 of stock), and that the situation as to the Lake Shore is further complicated by the restriction mentioned with respect to any future increase in its capital stock. The New York Central proposes to provide for the issuance, following the consolidation, of bonds secured by mortgage on the combined properties, to be available for refunding the present bonded debt of the two companies and for additional future capital needs of the consolidated company so far as those needs are to be met by the sale of bonds. It represents that such a simplified series of bonds, each of equal lien, would find readier confidence with the investing public than would the separate issues of the two companies, each subject to previous issues of prior lien, and that they would soon become established in the market as the consolidated company's standard bonds.[1]

9. *Disadvantages of consolidation.*—Consolidation, when it takes the form of an amalgamation, causes the dropping of the names of all the constituent companies; in the case of merger all but one of the names are dropped. With the loss of names there frequently disappears a considerable amount of valuable good-will. For that reason the Central Leather Company, for example, did not merge into itself the United States Leather Company, but preserved the

1 Report reprinted in full in Gerstenberg's "Materials of Corporation Finance," pp. 548–554.

name of the U. S. Leather Company by maintaining the separate existence of that company for selling purposes with a nominal capitalization of $100,000. Another objection to consolidation is the formal procedure with which it must be accomplished. Stockholders must be notified and their consent must be obtained. Usually some stockholder will raise objections, if only to use them for the purpose of blackmailing the company into paying him an exorbitant price for his stock. When, for example, the American Tobacco Company proposed to replace the bonds of the Consolidated Tobacco Company, one of the constituent concerns, with new bonds of its own, a suit was immediately brought by a bondholder, but the court pointed out that since the old bonds had been secured by common stock and the new bonds were to be secured by the property itself, the bondholder could have no objection.[1]

Another disadvantage of the fusion of companies by legal consolidation is that once formed, the consolidation cannot easily be undone.

10. *Intercorporate relations thru sale of assets.*—

[1] Dewing makes the same observation about all reorganizations, whether they result from consolidation or insolvency of the concern. Speaking of a suit that was brought at the time of the reorganization of the Corn Products Company, he says: "This incident illustrates admirably the difficulty of effecting a fair reorganization without the aid of the courts and a judicial sale of the company's property. There are always stockholders who consider themselves aggrieved. Most serious of all, there are always hordes of speculators and unscrupulous attorneys who stand ready to bring suit against a company, ostensibly to obtain rights in the name of justice, but actually to compel the large corporation to buy its peace at secret and exorbitant terms."

Two or more companies may fuse thru the purchase by one company of all of the operating assets of the others, paying in exchange therefor either cash or stock of the purchasing company. If cash is paid the vendors will probably wind up their affairs and distribute among the stockholders any surplus that is left after the payment of debts. If stock is paid it is likely that the vendors will dissolve by exchanging the stock they receive thru the sale of their assets for their own outstanding stock, thus making their stockholders members of the purchasing company.

11. *Right to buy and sell assets.*—In a great many states the general corporation laws make provision for the sale of assets by one company to another. These statutes, however, do not regulate the purchase of the assets of a corporation and it is generally considered that if the assets are necessary and can be used, no special statutory authority is necessary to purchase them. In the absence of statute, corporations have to fall back on the common law, the rules of which, tho somewhat complicated, are briefly summarized in the two following sections.

12. *Right of directors to sell corporate assets.*—Directors have no inherent right to sell out a prosperous or even a losing concern but generally they may make an assignment for the benefit of creditors of a company that is totally insolvent. The directors are the agents of the stockholders for the purpose of managing the company's affairs but are not authorized to transfer the property to another concern,

since such action would in effect, oust the stockholders from further interest in the operation of the corporate property. When, however, a company becomes insolvent the law regards its property as belonging primarily to the creditors. The directors are justified in recognizing the creditors' primary interest by making an assignment.

13. *Stockholders' rights to authorized sale.*—If all the stockholders agree they may sell the corporate property jointly on any terms they decide upon, and, if it is not *ultra vires* for the company to hold stock, they may accept stock of the purchasing company in payment. If a prosperous concern wishes to dissolve, the property may be sold as a step toward dissolution by such a majority of the stockholders as is required by statute to authorize the dissolution of the company. In most states a two-thirds majority of the stockholders is necessary. When the further prosecution of the corporation's business would be unprofitable, it is not only the right but the duty of a majority to wind up the company's affairs by a sale of all its assets. Public service corporations are ordinarily not permitted to sell all of their assets without the consent of the public service commission which has immediate jurisdiction over their property and its operation.

14. *Effect of sale.*—The effect of a sale of corporate property does not differ greatly from that of the sale of property between natural persons. In most states because such an operation has so frequently

been used to defraud creditors the sale in bulk of all the assets of a going concern, whether owned by an individual, partnership or corporation, is presumed to be fraudulent and those interested in the sale must bear the burden of proving that it is not fraudulent. If the selling corporation receives adequate consideration, whether in cash or in stock of the purchasing company, the corporate property will be transferred free from all claims except specific liens, such as mortgages. If the consideration is inadequate, creditors of the selling company may maintain an action to have the sale set aside as being a fraud on the creditors.

15. *Sale as a means of concentrating parts of an industry.*—One advantage of the sale lies in the fact that it may include such operating assets as are necessary to carry on a certain line of work, leaving the selling company with other operations that it wishes to continue. Thus in 1900, a number of gentlemen who had large interests in the tobacco industry wanted to consolidate the snuff business into one corporation. Several of them agreed to deliver to a proposed corporation all the capital of the Atlantic Snuff Company or all its property "real and personal (and the property of all corporations owned or controlled by it), together with its or their good-will, business and trade-marks." Another group agreed to convey only the "snuff business and good-will of the American Tobacco Company and Continental Tobacco Company, together with all the real and per-

sonal property" of those companies, "used by them or either of them, and pertaining to the snuff business of them or of either of them, and the good-will and trade-marks of the snuff business of said companies." A third group, in the same way, agreed to turn over the snuff business of the P. Lorillard Company. Here there was a fusion of one company with parts of three other companies.

16. *Consideration paid for assets.*—The amount of the consideration paid for a company's assets may be (1) a fixed sum, (2) a sum to be determined by an appraisal of the property to be sold, or (3) a sum consisting partly of a stipulated amount and partly of an amount determined by an appraisal of part of the assets. The third method is sometimes employed to solve the difficult question of determining the value of good-will, trade-marks and other intangible assets, for which a lump sum is agreed to be paid. The amount to be paid for the tangibles is often fixed by an expert appraisal. Usually the agreement of sale prescribes in detail the manner in which the appraisal shall be made.

17. *Advantages and disadvantages of sale.*—Tho there are differences which the lawyer would consider important between fusion by consolidation and by sale of assets, the two processes are similar in effect and therefore the advantages and disadvantages of one are substantially the same as the advantages and disadvantages of the other. A great advantage of

the sale, however, is that only the stockholders of one corporation, the selling company, need be consulted by the directors. It is easier, therefore, for a large corporation to absorb a small corporation by buying its assets than by consolidating with it.

18. *Intercorporate relations formed by lease.*—In the railroad and public utility field, more than in the industrial field, companies have been brought together by the lease. A lease is a transfer of possession and use, and is to be distinguished from a sale which includes a transfer of title. The consideration for a sale is usually a lump sum; the consideration for a lease is usually a number of sums, each called an instalment of rent. Where neither title nor possession is transferred, but rather the right to use assets, the transaction is called a license. Thus in the railroad business we find railroads using each other's tracks under so-called trackage contracts or traffic agreements and paying for the right in proportion to the use that is made of it. These payments are called traffic balances.

19. *Who can give a lease of corporate assets?*—In the absence of a statute to the contrary, the unanimous consent of the stockholders is necessary to grant a lease of corporate assets except when such action is taken as a step in the liquidation of a company, in which case the majority of the stockholders may agree to lease for a reasonable time. Under modern statutes, leases may be given by a vote of two-thirds or

three-fourths of the stock. Leases of public service properties are generally subject to the approval of public utility commissions.

20. *Form of lease.*—A lease of property begins with a description of the parties, lessor and lessee; this is followed by the statement that the property is conveyed, the grant or granting clause; then comes a description of the property, which may be contained in the lease in detail or in general only. In the latter case the description is usually supplemented by a schedule or inventory contained in a separate instrument. Then follows a clause with the object of limiting the grant. The next clause is the term, a statement of the commencement and duration of the lease. The last formal clause prescribes the amount, manner and time of payment of rent. Then follow the covenants, most of which are agreements on the part of the lessee or tenant company to maintain the property.

21. *Consideration for lease.*—Usually when a company leases its property it maintains only a nominal existence. It surrenders all its property to the lessee. Thus the lease of the West End Street Railway Company to the Boston Elevated Railway Company transferred not only the ordinary operating properties of the former company, but its "materials and supplies and cash on hand at the inception of this lease, and all accounts and notes receivable, easements, privileges and appurtenances thereto belonging, together with the right to demand and receive all tolls,

rent, revenue, income and profits of the demised premises." [1] All expenses of the leasing company such as ordinary franchise taxes, interest on bonds and salaries of officers are met by the lessee. They constitute part of the rent. The tenant even agrees to furnish "sufficient and suitable offices" with "appropriate furniture and fittings" in which the officers of the landlord can meet. And finally the tenant agrees to pay dividends to the landlord's stockholders. Frequently the dividends are stipulated in the lease, but in some cases the rate is made to depend on the earnings of the property. Where the rate varies with the earnings, knotty problems of accounting are frequently met, the chief of which involves the question whether certain expenditures should be charged to operating expenses or to the capital account. While the flat rate avoids these difficulties, it may work hardship in the distant future if, thru circumstances beyond the control of the tenant, the property ceases to make fair earnings.

22. *Who owns improvements on leased premises?* —A familiar rule of the law of landlord and tenant provides that upon the termination of the lease all permanent improvements revert with the estate to the landlord. This rule has been the stumbling block in some of the old railroad leases. Thus the New York Central had a lease of almost 500 years' duration of the Harlem River Railroad's property, when it be-

[1] For complete text of the lease, see Gerstenberg's "Materials of Corporation Finance," pp. 555–569.

came apparent that to meet the competition of other suburban roads the Central would have to electrify the Harlem's property. Tho the lease had a long period still to run, the Central did not care to make the necessary expensive improvements on its landlord's property. It therefore undertook to purchase the stock of the Harlem. This stock was receiving eight per cent dividends under the lease and was worth between $150 and $200 a share. But the Central found that the Harlem stockholders would not part with their stock except at fancy prices, frequently demanding as much as $500 a share.

A fair solution of this problem has been accomplished by modern leases, which provide that all improvements shall be paid for with the proceeds of securities of the landlord. Since the tenant agrees to meet the interest or dividend charges on these securities during the term of the lease, it pays an increased rental for the property whenever the bonds or stock are issued, but the landlord assumes the capital obligation for which it is compensated thru its ownership of the added property.

23. *Lease as a means of manipulation.*—Leases have sometimes been used by corporations to avoid some of their obligations. An example will make the method plain. In 1890 the National Cordage Company offered $5,000,000 preferred stock to the public and agreed in a by-law not to create any bonded debt, except with the consent of holders of record of at

least eighty per cent of their preferred stock. In 1891 the company wanted to raise $6,000,000 to buy certain competing properties. A subsidiary issued its bonds for that amount, and leased its properties to the National Cordage Company. The rent paid by the Cordage Company consisted of $300,000, this being the amount of interest on the bonds and an annual sinking fund payment of $225,000. Then the parent company guaranteed payment of both principal and interest. Thus the National Cordage Company avoided its obligation to its preferred stockholders, while it obtained actual control of the properties and in effect paid for them with an issue of bonds.

24. *Other possibilities for manipulation.*—Sometimes leases have been used to kill competition. For example, a railroad will lease a dock in order to take terminal facilities from a competing steamship line. When the lease terminates, the dock company finds that its property has been abandoned and is worthless as dock property. In carefully drawn leases clauses are always inserted that the leased property shall be kept in operation and that the lessee shall not build or operate competing properties. Covenants are also included whereby the lessee promises to keep the property in good repair and to permit the lessor to make reasonable inspection of the properties to see that they are being satisfactorily maintained. But merely to repair property is not sufficient. It must be maintained as a going concern. And so

clauses are usually inserted that the properties "will be as well fitted for independent use and operation by the lessor as at the inception of the lease."

25. *Duration of lease.*—A lease may be made for any term of years. Frequently leases have been made for 999 years or for 99 years, renewable forever. Default clauses provide that the lessor may recover possession of its property upon breach of any of the lessee's covenants. At the termination of the lease, the lessee is required to "surrender the real and personal estate demised under and by virtue of (the) indenture . . . in the like good order and condition in which they are at the inception of (the) lease . . . with all improvements thereon and additions thereto, the amount of money, materials and supplies to be surrendered or accounted for to the lessor to be equivalent in value to the amount on hand at the inception of (the) lease."

26. *Effect of lease.*—As we have seen, the lessor ceases to be an operating company. In fact, it may lease all of its operating property including its cash and accounts receivable. Hence all obligations arising out of the operation of the property rest on the tenant. Moreover, the tenant is required to make all repairs, and while, under the law and in the absence of specific contract, the landlord is bound to pay taxes and insurance, this burden is usually shifted to the tenant by clauses contained in the lease.

27. *Advantages of lease.*—Since a lease of property does not require the payment of any large sum

of money except such as can be obtained thru the operation of the leased property, this form of intercorporate relation commends itself as a means of avoiding rearrangement of finances. No new securities need be sold, no promoters' profits or bankers' commissions need be paid.

Leases of parts of properties have frequently been made by small public service corporations under circumstances that may be outlined as follows: A suburban gas or electric company has a distributing system reaching in toward a city. Afterward, the territorial jurisdiction of the city is enlarged and part of the distributing system falls within the new city boundaries and thus comes within a territory where rates are so low that the company cannot afford to distribute its service. The larger metropolitan system will then lease this property for a rent sufficient to meet the capital obligations of the smaller company represented by the leased property. Thus the company does not lose its fixed investment and avoids operating on a losing basis.

28. *Disadvantage of lease.*—The chief disadvantage of the lease is that it is either inflexible and creates a rigid plan of compensation for the use of property that thru unforeseen circumstances may become worthless or immensely valuable, or, if it is flexible, it may open the door for manipulation and litigation. There is generally a disposition on the part of the tenant to treat the property with less consideration than its own property, and on the part of the landlord

a fear that it is not being fairly treated. Certainly the inducement to improve the property is stronger when it is owned than when it is leased. That leases are used less now than formerly, is strong evidence that the disadvantages are serious.

## REVIEW

What is the difference between consolidation and amalgamation?

Suppose you held stock in a New York corporation which was about to consolidate with another corporation, and that you disapproved of the consolidation, what would you do about the matter?

Corporation A has powers X, Y and Z. Corporation B has powers X and Y. May they consolidate?

Which is the easier method of forming intercorporate relations —by consolidation or by sale of assets?

Enumerate the advantages of consolidation over a lease of assets.

Why do companies, in leasing their assets, sometimes include their cash and accounts receivable?

## CHAPTER XVII

### HOLDING COMPANIES

1. *Rise of the holding company.*—Shortly after the arrangement of intercorporate relations thru the use of voting trusts had been declared illegal in the oil and sugar industries (1890–1892), the device of the holding company became popular and was widely heralded as the ultimate scheme of the trust lawyers to circumvent the anti-trust laws. Certainly, it was argued, the courts could not prevent a corporation from holding property if it was given that right by the laws of the state in which it was incorporated. The fact that the property happened to be stocks of competing companies was considered to be immaterial. And this view was strengthened, in 1895, by a decision of the Supreme Court in the Knight case, in which the holding of stock in four independent concerns by the American Sugar Refining Company was not condemned. But, in 1904, the same court more carefully examined the device of the holding company and held that if it was merely a legal method of committing an illegal act—the act of forming a monopoly—it would be ordered to dissolve. Since it was during the period from 1890 to 1904 that most of the

large industrial combinations were formed, a number of them, including the United States Steel Corporation, still exist in the form of holding companies.

2. *Magnitude of interests involved in holding company control.*—In a brief submitted on behalf of the public utility holding companies of the country to the Interstate Commerce Committee of the United States Senate, the proportion of the public utility business of the country in the hands of holding companies was shown to be very large.

The total capital employed in electric, gas, street and interurban railway companies commonly called public utility corporations, in this country today is estimated to exceed eight billion dollars. Of this capital nearly five and a half billion dollars are controlled by holding companies and their subsidiary companies. Of the approximately 89,000,000 people served by electric light and power and gas companies over 62,000,000 (approximately 70 per cent) are served by holding company systems.

The electric light and power companies represent approximately two billion dollars of capital, of which approximately 76 per cent is controlled by the holding company form of organization. These utilities serve over 50,000,000 people, approximately 38,000,000 of which are served by holding companies. Of 577 cities of 10,000 or more population served, 428 are served by holding company systems. Of the 114 cities in the United States of a population in excess of 50,000, 103 are served by holding companies. Of the 54 cities in this country having in excess of 100,000 population, 49 are served by the holding company.

Artificial gas companies represent a capital of approximately one and one-third billion dollars. Of that capital, approximately two-thirds is controlled by holding companies. The gas utilities of the country serve approximately thirty-eight and one-half million people. Of this number nearly

twenty-five million are served by holding companies or their subsidiaries.

Street and interurban railway companies represent a total capital of approximately five billion dollars. Of this sum it is estimated that not less than two-thirds is controlled by holding companies. In the 28 cities of the United States having a population in excess of 200,000, the mileage of track controlled by holding companies is in excess of 61 per cent. Here, again, it is of interest to note that only four of these cities have more than one principal operating company and only two of these cities have companies that are really independently and separately owned.[1]

3. *Classification of holding companies.*—Some companies, like the United States Steel Corporation, the old Rock Island Company and the American Power and Light Company, are purely holding companies; they exist merely to hold stock of several other corporations but undertake no operations on their own account. They are simply administrative in function. To such corporations may be applied the term holding companies. Other corporations, like the Jones and Laughlin Steel Company, New York Central Railroad and the Interboro Rapid Transit Company of New York City, operate property of their own, besides controlling other companies thru stock ownership. Such companies are called parent companies. The companies whose stock is held are known as subsidiaries.

4. *Right of a company to hold stock in other companies.*—In England, one of the implied powers of every corporation is to hold stock of other similar

1 Gerstenberg's "Materials of Corporation Finance," pp. 570–582.

companies. In the United States, the common law of corporations has been interpreted as not including this power among the implied powers of a corporation, except in the case of insurance companies, savings banks and other institutions that exist for investment purposes. Most states, by statute, have now given this power to corporations. In New York State the right of a company to hold stock in other companies must be claimed among the express powers set forth in the certificate of incorporation. In New Jersey, a law was passed in 1913 restricting the right to acquire and hold stock to such cases where the acquisition is necessary for the corporation's business, but the word "necessary" has been interpreted by the courts to mean "expedient" and not "indispensable."

5. *Companies.*—The Dominion Act provides (Sec. 66) that "a company shall not under any circumstances use any of its funds in the purchase of stock in any other corporation, unless or until the directors have been expressly authorized by a by-law passed by them for the purpose and sanctioned by a vote of not less than two-thirds in value of the capital stock represented at a general meeting of the company duly called for considering the subject of the by-law: provided that if the letters patent authorize such purchase it shall not be necessary to pass such by-laws."

It is customary, therefore, in applying for a charter to include among the powers the right to use the company's funds for the purchase of stock of other com-

panies. When a company, without authority, acquires stock of another company, the stockholders of the acquiring company may object, but the stockholders of the company whose stock is acquired are not permitted to do so.

As was stated above, these laws bear upon the right of the corporations involved to do the single act of acquiring and holding stock. If such acquisition involves as an incident, another act—the formation of a monopoly, which is illegal, the transaction will be condemned, as we shall see, as a violation of law. To illustrate, it may not be illegal to shoot off a gun; if the gun is aimed in the direction of a human being and the shooting involves the killing of a human being, certainly no one would seek to set up as a defense the fact that it is legal to fire a gun.

6. *Ownership of majority of stock not necessary for control.*—There are many reasons why the control of a subsidiary may be obtained by a parent company without an investment in fifty or more per cent of its stock.

(a) In the first place the controlling minority is usually closely organized, while the outside majority is scattered.

(b) The organized minority may be a majority of the shares actually voting. In the large corporations, only a small number of persons attend the meetings or send in their proxies. In the large railroad companies of the United States perhaps sixty per cent of the

stock is a fair amount to be represented at a meeting. It will be seen, therefore, that about 31 per cent is sufficient to control the meeting.

(c) The stockholders of a company usually receive in the same envelop with their notice of a meeting, a request to sign a proxy in favor of a committee nominated by the board of directors, and a stamped envelop in which to return the executed proxy. It is said that at the annual meeting of the New York, New Haven and Hartford Railroad Company on October 28, 1914, the president of the company exercised proxies with respect to more than 60 per cent of the outstanding stock of the company, and more than 98 per cent of that represented at the meeting.

(d) There is a general disposition on the part of outside investors to cast their lot with the party in power. Investors represent the conservative element of society, those who believe in things as they have been. It would be extremely difficult for an outsider to organize a hostile majority by making an appeal to the average stockholder.

At a meeting of the Chicago, Rock Island and Pacific Railroad held April 12, 1915, a minority committee, after the most strenuous campaign to get proxies, succeeded in procuring only about one-third as many shares as were held by a majority committee. In 1913, one Isaac M. Cate sent out elaborate booklets complaining of the acts of the directors of the American Locomotive Company, and inclosing proxies with stamped and addressed envelops in which the exe-

cuted proxies might be returned to him. His efforts were wholly unavailing.

(e) Stock may be divided into voting and non-voting classes, or a small class of stockholders may be given the right to elect a majority of the directors. When the American Tobacco Company was formed in 1904, it issued about twice as much preferred stock as common stock, but the common held by the insiders was voting stock, while the preferred was deprived of that privilege. Another interesting example is seen in the formation of the Rock Island Company in 1902 with about $50,000,000 preferred and $90,000,000 common. This time, the insiders held the preferred stock, for that issue was given the right to elect five of the nine directors.

(f) Large individual stockholders of the subsidiary may be owners of the parent company, and vote with it to control the subsidiary. The Gould and Vanderbilt families thus frequently kept their hands on both the parent and subsidiary roads of their railroad systems, by holding in their own names, such proportion of the stock of the subsidiaries as would give their parent companies control of over 51 per cent of the subsidiaries' voting stock.

(g) A final reason why less than a majority of the stock may control a company is illustrated by the Des Moines Union Railway Company, whose articles of incorporation provide that a director cannot be elected, the articles of incorporation amended, or the capital stock increased, except by a vote of more than

seven-eighths of the stock. If the board of directors of this company own slightly more than one-eighth of all the stock, their tenure of office is secure.

7. *Why stockholders surrender control of subsidiaries to parent company.*—When corporations consolidate all their assets or all their stock, some inducements are held out to the stockholders to urge them to turn the control of their properties over to another company. To be sure, there have been cases where corporate waifs have sought parents instead of the parents looking about for foster children. In this way the New York Central had thrust upon it the West Shore road, and the Atlantic Coast Line had unloaded upon it the Louisville and Nashville. But the Cincinnati, Hamilton and Dayton is the champion wanderer among railroads. Since it was first scuttled in 1886, the interests that controlled it tried successively to palm it off on the Baltimore and Ohio, on the Vanderbilt roads and on the Erie, and finally succeeded in dumping it on the Baltimore and Ohio in 1911. At this writing the road is going thru reorganization.

Sometimes corporations are started merely to blackmail existing corporations into buying them up. Numerous examples of the creation of such "cat-tails" can be found in railroad history. Dr. A. S. Dewing [1] says that in a conversation with an old member of the National Cordage Company, he was told that some people prepared a cordage mill in Pennsylvania with

[1] "Corporate Promotions and Reorganizations," p. 129, note.

"wooden painted shafting and nicely painted, but useless machinery. It might have cost $5,000 to prepare the hoax; the officers of the National Cordage Company paid $180,000 for it!"

8. *Technical advantages resulting from plants combining.*—Frequently an appeal is made to stockholders on the ground that the technical advantages obtained thru combining plants are sure to result in enormous profits. From an early prospectus of the United States Shipbuilding Company, we may learn how these benefits would be brought about:

> The acquirement by this corporation of all the plants and properties above stated presents distinct advantages, as stated by Naval Constructor F. T. Bowles, in his report dated December 22, 1900, as follows:
>
> 1. Each concern builds that for which it is best fitted and equipped, or that which its character, location and labor can accomplish most economically.
>
> 2. Structural materials, steel, iron, timber, etc., can be purchased at the lowest rates, a prompt supply secured at points where it is most needed.
>
> 3. The technical knowledge of design, which comes from experience, records, and data of each concern, will be combined, thus giving confidence to customers that the results contracted for shall be attained.
>
> 4. The healthy professional rivalry of the various yards can be utilized to produce the best results in design, construction and administration, without the disastrous and narrowing devices of destructive competition.
>
> 5. The standardization of the numberless details of ship fittings, auxiliaries and appliances, which are now almost as various and incongruous in design as they are in number, and their production in quantity by those best qualified, would produce enormous economies.

6. It will be possible to effect great economies by the separation of warship and merchant construction into different establishments, thus avoiding the difficulties of organization and increased cost of radically different types of construction upon adjoining ships.

7. The better organization and management of the individual concerns would be a necessary and direct result of this incorporation.

9. *Other advantages derived from combination.*—Of course the most important advantage of combining business is to eliminate competition. Under a monopolistic régime, prices may be made higher, jobbers' profits eliminated and a large number of operating economies may be practiced. All the advantages of large-scale production may be enjoyed, such as purchasing at low prices in large quantities, saving by-products, saving in cross freights, saving in selling expenses and in advertising. Moreover, all the plants can select and use the best patents, trade-marks and trade names, and thus get the advantage of the best products of each plant. Finally, a large corporation finds it easier to make and to retain sound banking connections than a small one.

10. *Advantages of the holding company.*—The advantages above enumerated apply to all forms of intercorporate relation. We have still to consider the technical advantages of stock-ownership as distinguished from the other legal devices—consolidation, sale of assets and lease of assets. In the first place, the system of a holding company with subsidiaries may be the only method open under the law. It is difficult

for corporations of two different states to consolidate. This is especially true if they are engaged in a public service business, and hence we find a great number of holding companies in the public service field, some of which control as many as nineteen or twenty public service properties, located in nearly as many states. Then, too, the laws of some states, for example, Pennsylvania, prohibit the holding of real estate by foreign corporations. In fact, in many ways it is better to retain the separate corporate existence of local plants in order that they may be more easily adjusted to local conditions.

By forming new companies for fresh ventures the capital invested in successfully established enterprises is not hazarded. The expense of obtaining subsidiaries is slight, since only a small proportion of the stock is required to maintain control. This stock can be deposited as security for collateral bonds, from the proceeds of which the parent company can reimburse itself for the money spent in acquiring the stock. Moreover, by retaining the identity of the subsidiary companies, instead of consolidating them, a spirit of emulation may be stirred up, and the old managers may retain their nominal titles instead of becoming subordinates in a large consolidation.

Judge Gary praised the organization of the United States Steel Corporation on just this ground. He said:

> We believe these subsidiary companies having their boards of directors and their officers, consisting of presidents, vice-

president, etc., have more responsibility and reach a higher success in the management of the properties in their charge than they would if they were simply the managers of these mills as departments. . . . We have now what we call the deadly parallel columns. . . . I mean by that that we have cost sheets, showing the costs of the different products at the different mills of the different companies and when these come up for examination and it is ascertained that the costs at one mill or at one company are larger than they are in some other place, then, of course, we bring these people together and ask them to find out why it is, and we endeavor to adopt all the best methods which have been in use at the lower-cost mill in the other mills, to reduce the costs of all.[1]

11. *Financial companies.*—While discussing holding companies some attention should be paid to those which exist chiefly for the purpose of facilitating the financial operations of other companies, or of other enterprises. The best known of these holding companies are the mortgage companies that do business in the large cities, by taking mortgages on real estate, and depositing these with a trustee as security for their own bonds. The bonds are often issued in $100 denominations, tho sometimes $10 certificates are first issued, to be subsequently exchanged for the $100 bonds. This device is perhaps the most successful yet used to make real estate the basis of liquid securities.

Another form of financial company is that used by some of the large equipment companies. In most states the public utility commission laws provide that bond or note issues, maturing in less than one year,

[1] Hearings before the Committee on Investigation of United States Steel Corporation 1911, pp. 103–04.

need not be sanctioned by the commission. The large suppliers of electrical equipment find themselves burdened with one year notes, and to change these into usable funds is the problem they have solved by means of financial companies. The practice of the General Electric Company in this respect is described thus:

Various finance and operating companies have been incorporated by the General Electric interests, which have general charge of the management of local companies, and the placing of their securities. Among the purely finance companies of this character are the Electrical Securities Corporation and the Electric Bond and Share Company. If, for example, an independent engineer wishes to purchase electrical equipment for a hydro-electric plant in West Virginia, he might buy the machinery from the General Electric Company, paying partially with the bonds and stocks of the projected enterprise. The Electrical Securities Corporation might then take over the securities, deposit them, together with others, with a trustee, and issue collateral trust bonds against them. These bonds would be readily sold to investors. In this way the parent company secures the business upon which it realizes cash, while the managers of the local enterprises are not compelled to dispose of securities at a sacrifice. The details of the plan may be illustrated by taking a case in which the General Electric interests directly operate the local company. Suppose it is thought wise to entirely reorganize the small company that supplies light and power to Forth Worth, Texas. The enterprise may be financed by the Electric Bond and Share Company, which will undertake a general supervision of the work thru a subsidiary organization, the Southwest Utilities Company. The local company will have the benefit of superior engineering skill and the most modern and efficient machinery. The local Fort Worth Company would pay the Electric Bond and Share Company for its cash advances in its own bonds, preferred and common stocks, and with this cash it

would pay the local interests for the old plant, and the General Electric Company for the new machinery. The bonds placed upon the property would represent about 70 to 80 per cent of its cost. These bonds, bearing five per cent interest, could be sold to a bond dealer for about 91 per cent, who would distribute them to the public at about 96 per cent. Such bonds are often sold without the intervention of bond houses. The preferred stock would be issued for the remaining 20 or 30 per cent of the actual cost. This stock bearing seven per cent interest, could be sold for about 94¾ to bankers who would distribute it in small lots to the public at about par. The common stock would go directly into the treasury of the Electric Bond and Share Company or its subsidiary, and would be held there in the interest of the parent corporation until it acquired substantial value thru the increased earning power of the local company. Sometimes, as in the case of the American Power and Light Company, another affiliated corporation of the General Electric, these common stocks of local enterprises are used as collateral for the issue of high interest bearing, short term bonds.[1]

12. *Management companies.*—A distinct kind of holding company that has grown up within the last ten years is the so-called management company in the public utility field. A typical example is J. G. White and Company, Incorporated. Its subsidiaries are the following companies:

The J. G. White Engineering Corporation, New York.
The J. G. White Management Corporation, New York.
Engineering Securities Corporation, New York.
Investors Securities Corporation, New York.
J. G. White and Company, Limited, London.
Municipal and General Securities Company, Ltd., London.

[1] Dewing's "Corporate Promotions and Reorganizations," p. 176.

The engineering and management corporations, until 1913, were departments of J. G. White and Company, Incorporated. In that year they acquired the good-will, business in hand, contracts, organization, equipment and other assets of the engineering, construction and management departments respectively of the parent company, which in turn, acquired the common stock of both subsidiaries. The parent company continued as an active financing and owning company in the general field of engineering and public utility enterprise.

The work of the engineering and management corporations was described by the company in an announcement of the incorporation of the two subsidiaries as follows:

THE J. G. WHITE ENGINEERING CORPORATION takes over the entire business of the former Engineering-Construction Department, including the Reporting, Appraisal and Purchasing Divisions, and acquires an exceptional staff of well-known engineers. It will design and construct hydro-electric power plants, central stations, steam railways, street and interurban railways, gas plants, pipe lines, bridges, transmission lines, distribution systems, industrial plants, harbor improvements and water works; and sanitation, sewerage, drainage and irrigation systems. It will also render consulting engineering services, make engineering reports, physical valuations and appraisals and will purchase materials and supplies.

During the year ending October 1, 1912, the Engineering-Construction Department was at work on contracts aggregating in cost over $28,000,000, while appraisals and reports were made during the same period on properties and projects aggregating over $400,000,000 in value. Important engi-

neering services were rendered thruout thirty different state and Canada. They included the rehabilitation of several public service properties; the construction and equipment of two high-speed interurban electric railways; the drainage of 118,000 acres in Florida; and a natural gas pipe line 124 miles long, the first of its kind to be put down in California, noteworthy for establishing a record of highest pressure ever employed.

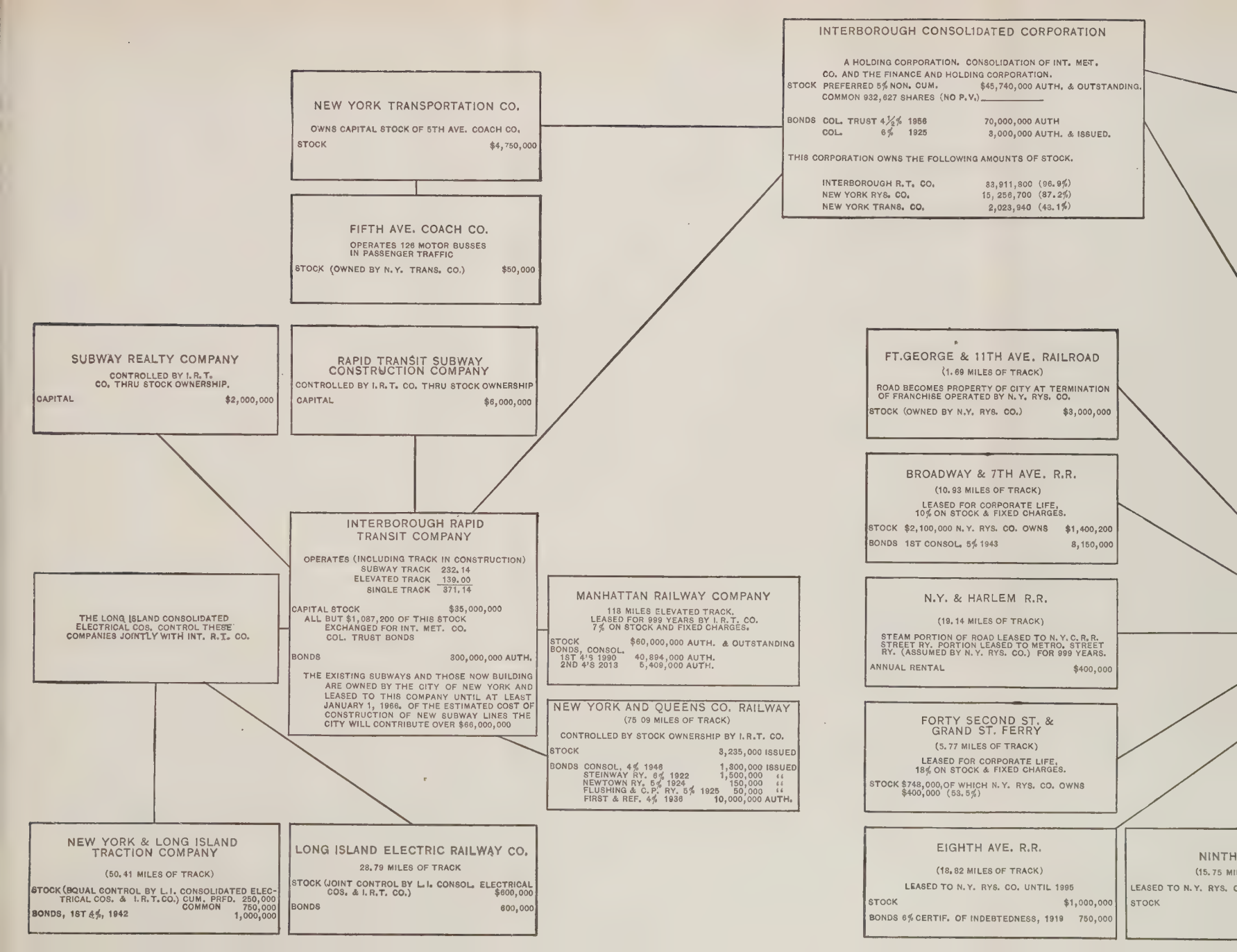
The position of J. G. White and Company, Incorporated as builders of American water powers was maintained with prestige by work on hydro-electric developments aggregating ultimately 426,000 horse-power.

13. *Complexity of intercorporate relations.*—In large corporate enterprises, particularly those with a long and varied history, there is often an amazing complexity in the relations of parent and subsidiary companies. This is aptly illustrated in the accompanying chart of the Interboro Metropolitan system in New York City. A study of the chart will show that in the earlier combinations which took place among street transportation companies, the usual form was the lease, but in the more recent combinations the holding company has been chiefly used.

## REVIEW

A book-publishing concern proposes to publish a magazine. Suggest a method of financing the venture, pointing out the superiority of your plan over other possible plans, and also any weaknesses that may be advanced against your plan.

If you had stock in a small company paying 5 per cent dividends, under what circumstances would you exchange your stock for 5 per cent bonds of a holding company, secured by the de


INTERBOROUGH CONSOLIDATED CORPORATION
A HOLDING CORPORATION. CONSOLIDATION OF INT. MET. CO. AND THE FINANCE AND HOLDING CORPORATION.
STOCK PREFERRED 5% NON. CUM. $45,740,000 AUTH. & OUTSTANDING.
COMMON 932,627 SHARES (NO P.V.)
BONDS COL. TRUST 4 1/2% 1956 70,000,000 AUTH
COL. 6% 1925 3,000,000 AUTH. & ISSUED.
THIS CORPORATION OWNS THE FOLLOWING AMOUNTS OF STOCK.
INTERBOROUGH R.T. CO. 83,911,800 (96.9%)
NEW YORK RYS. CO. 15,256,700 (87.2%)
NEW YORK TRANS. CO. 2,023,940 (43.1%)
NEW YORK TRANSPORTATION CO.
OWNS CAPITAL STOCK OF 5TH AVE. COACH CO.
STOCK $4,750,000
FIFTH AVE. COACH CO.
OPERATES 126 MOTOR BUSSES IN PASSENGER TRAFFIC
STOCK (OWNED BY N.Y. TRANS. CO.) $50,000
SUBWAY REALTY COMPANY
CONTROLLED BY I.R.T. CO. THRU STOCK OWNERSHIP.
CAPITAL $2,000,000
RAPID TRANSIT SUBWAY CONSTRUCTION COMPANY
CONTROLLED BY I.R.T. CO. THRU STOCK OWNERSHIP
CAPITAL $6,000,000
FT. GEORGE & 11TH AVE. RAILROAD
(1.69 MILES OF TRACK)
ROAD BECOMES PROPERTY OF CITY AT TERMINATION OF FRANCHISE OPERATED BY N.Y. RYS. CO.
STOCK (OWNED BY N.Y. RYS. CO.) $3,000,000
BROADWAY & 7TH AVE. R.R.
(10.93 MILES OF TRACK)
LEASED FOR CORPORATE LIFE, 10% ON STOCK & FIXED CHARGES.
STOCK $2,100,000 N.Y. RYS. CO. OWNS $1,400,200
BONDS 1ST CONSOL. 5% 1943 8,150,000
INTERBOROUGH RAPID TRANSIT COMPANY
OPERATES (INCLUDING TRACK IN CONSTRUCTION)
SUBWAY TRACK 232.14
ELEVATED TRACK 139.00
SINGLE TRACK 371.14
CAPITAL STOCK $35,000,000
ALL BUT $1,087,200 OF THIS STOCK EXCHANGED FOR INT. MET. CO. COL. TRUST BONDS
BONDS 300,000,000 AUTH.
THE EXISTING SUBWAYS AND THOSE NOW BUILDING ARE OWNED BY THE CITY OF NEW YORK AND LEASED TO THIS COMPANY UNTIL AT LEAST JANUARY 1, 1966. OF THE ESTIMATED COST OF CONSTRUCTION OF NEW SUBWAY LINES THE CITY WILL CONTRIBUTE OVER $66,000,000
THE LONG ISLAND CONSOLIDATED ELECTRICAL COS. CONTROL THESE COMPANIES JOINTLY WITH INT. R.T. CO.
MANHATTAN RAILWAY COMPANY
118 MILES ELEVATED TRACK.
LEASED FOR 999 YEARS BY I.R.T. CO.
7% ON STOCK AND FIXED CHARGES.
STOCK $60,000,000 AUTH. & OUTSTANDING
BONDS, CONSOL.
1ST 4'S 1990 40,894,000 AUTH.
2ND 4'S 2013 5,408,000 AUTH.
N.Y. & HARLEM R.R.
(19.14 MILES OF TRACK)
STEAM PORTION OF ROAD LEASED TO N.Y.C.R.R. STREET RY. PORTION LEASED TO METRO. STREET RY. (ASSUMED BY N.Y. RYS. CO.) FOR 999 YEARS.
ANNUAL RENTAL $400,000
NEW YORK AND QUEENS CO. RAILWAY
(75.09 MILES OF TRACK)
CONTROLLED BY STOCK OWNERSHIP BY I.R.T. CO.
STOCK 3,235,000 ISSUED
BONDS CONSOL. 4% 1948 1,800,000 ISSUED
STEINWAY RY. 6% 1922 1,500,000 "
NEWTOWN RY. 5% 1924 150,000 "
FLUSHING & C.P. RY. 5% 1925 50,000 "
FIRST & REF. 4% 1936 10,000,000 AUTH.
FORTY SECOND ST. & GRAND ST. FERRY
(5.77 MILES OF TRACK)
LEASED FOR CORPORATE LIFE, 18% ON STOCK & FIXED CHARGES.
STOCK $748,000, OF WHICH N.Y. RYS. CO. OWNS $400,000 (53.5%)
NEW YORK & LONG ISLAND TRACTION COMPANY
(50.41 MILES OF TRACK)
STOCK (EQUAL CONTROL BY L.I. CONSOLIDATED ELECTRICAL COS. & I.R.T. CO.) CUM. PRFD. 250,000
COMMON 750,000
BONDS, 1ST 4%, 1942 1,000,000
LONG ISLAND ELECTRIC RAILWAY CO.
28.79 MILES OF TRACK
STOCK (JOINT CONTROL BY L.I. CONSOL. ELECTRICAL COS. & I.R.T. CO.) $600,000
BONDS 600,000
EIGHTH AVE. R.R.
(18.82 MILES OF TRACK)
LEASED TO N.Y. RYS. CO. UNTIL 1995
STOCK $1,000,000
BONDS 6% CERTIF. OF INDEBTEDNESS, 1919 750,000
NINTH
(15.75 MI
LEASED TO N.Y. RYS. C
STOCK

posit of the stock of your company and several other small companies?

What is the purpose of financial companies?

What are the advantages of management companies in the public utility field?

# CHAPTER XVIII

## ILLEGAL COMBINATIONS

1. *History of the common law of monopolies.*—It is unnecessary to treat at length the legal history of monopolies. But it must not be supposed that they are an American product of the nineteenth century. They were as virile and as strongly condemned in the seventeenth century as they are in the twentieth.

> "If any asks what things these monsters be,
> 'Tis a Projector and a Patentee."

These lines stood as the title of a picture that visualized the "octopus" of those early days.[1] Monopolies have been the subject not only of individual invective, but also of political and judicial condemnation. In a long series of decisions, beginning in 1602 with the famous case brought against Darcy, the favorite of Queen Elizabeth, from whom Darcy had received a patent conferring on him the exclusive privilege to manufacture playing cards, down to the sugar and oil cases of the last decade of the nineteenth century, we find monopolies condemned because the principle on which they are based is contrary to public policy and

[1] For a complete account of the history of monopolies see Levy's "Monopoly and Competition."

because the monopolies themselves are injurious to the public welfare.

2. *What is the common law of monopolies?*—These decisions holding monopolies to be illegal are the basis of the common law of monopolies, which has been commented on as follows by Noyes in his "Intercorporate Relations":

> Any combination of corporations or individuals the object of which is, or the necessary or natural consequence of the operation of which will be, the control of the market for a useful commodity, is against public policy and unlawful.
>
> Any combination of quasi-public corporations the object of which is, or the necessary or natural consequence of the operation of which will be, the increase of charges beyond reasonable rates, or the curtailment of facilities afforded the public, is against public policy and unlawful.[1]

It appears, then, that even if there had never been entered on the statute books a single anti-trust act, the Standard Oil Company, the American Tobacco Company and the many other companies that have been successfully prosecuted under the Sherman Act would have been condemned as violations of the common law.

3. *Violations of the common law of corporations.*—It has been shown that corporations, being creatures of the state, are strictly limited in regard to the powers that they can exercise. The state jealously guards its creatures from assuming any rights or performing any acts that would tend to make the creature greater than the creator. Therefore, the common law has al-

[1] P. 634.

ways said that certain acts could not legally be committed by corporations; and it has been held that the prohibitions thus defined have frequently been violated by companies forming intercorporate relations. These prohibitions may be enumerated as follows:

(a) Corporations may not become members of a partnership unless specially authorized by their charter or otherwise. In the following words, the Cotton-Seed Oil Trust was condemned by a Tennessee court, in 1888, two years before the passage of the Sherman Anti-Trust Act.

> A careful examination of this agreement discloses every material element of the contract of partnership. The absolute ownership of the corporate property, the mills, machinery, etc., is not conveyed to the partnership, nor is this necessary. The beneficial *use* of all such property is surrendered to the common purpose. The provisions for the complete possession, control and use of the properties of the several corporations by the partnership or syndicate is perfect. Nothing is left to the several corporations but the right to receive a share of the profits and participate in the management and control of the consolidated interests as members of the new association. The contract is, both technically and in its essential character, a partnership, in so far as it is possible for corporations to form such an association.[1]

(b) Corporations may not delegate their powers, but must exercise them themselves thru their own stockholders and directors. It was largely on account of the violation of this principle of common law that

[1] Mallory vs. Hanaur Oil Works, 86 Tenn., 602.

the old Standard Oil Trust [1] was compelled by a court of the State of Ohio to disband in 1892.

(c) Corporations may not consolidate without statutory consent, and then only in the manner prescribed by the statute. The Sugar Trust was condemned by the Court of Appeals of New York on the ground that it amounted to a consolidation of the constituent companies and that it did not observe the provisions of the statute relating to consolidations.

(d) Corporations may not hold stock of other companies without statutory authority. Therefore a holding company may not be formed unless the state has enacted a statute permitting corporations to hold stock of other companies.

4. *Anti-trust statutes.*—It would seem that these various provisions of the common law of monopolies and of the common law of corporations should have been sufficient to protect the public against the trusts. But public opinion, during the last two decades of the nineteenth century, was strongly opposed to these combinations. It had to find expression in legislative enactment. The states and the Federal government took up the question at about the same time and thru the authority of legislative acts prohibited the formation of trusts.

Most state laws declare unlawful contracts and combinations in restraint of trade or competition.

[1] It will be remembered that both the Standard Oil Trust and the Sugar Trust, mentioned in the next paragraph, were formed by the creation of similarly controlled voting trusts in the several competing concerns.

They declare that guilty parties, if individuals, are to be punished by fine and imprisonment; if domestic corporations, they are to lose their charters, and if foreign corporations, they are to be ousted from the state. In some jurisdictions, notably Texas, the trust laws have been vigorously enforced. In most states, persons injured by a combination are given a right of action, and usually the method of calculating damages is defined.

5. *Sherman Anti-Trust Act and amendments.*—In 1890 Congress passed the Sherman Anti-Trust Act. Several amendments have since been added, including the Expedition Act, by virtue of which appeals from decisions of the lower courts may be taken directly to the Supreme Court. The most notable of these amendments are the Federal Trade Commission Law and the Clayton Act of 1914.

6. *Meaning of Federal anti-trust laws.*—Certainly the person who does not recognize the far-reaching effect of the Sherman Law on business, must be an indifferent member of society. During the twenty-five years of its existence its terms have been discussed, its meaning analyzed and its effect predicted. The United States Supreme Court never had a more difficult task before it than to interpret the meaning of the anti-trust laws and to apply the laws properly in connection with the large interests whose fates have rested upon their momentous decisions.

Some claim that the court has faced about com-

pletely in its attitude toward the law, since at first it seemed decidedly indifferent. Possibly in the first case under the law, U. S. vs. E. C. Knight Company (1895), the court did not fully appreciate the statute, and therefore did not recognize the strength of public opinion in favor of the act. It has been hinted that the trust lawyers were too crafty for the government attorneys who had charge of the prosecution. But when, in 1898, the railroad pool (U. S. vs. Joint Traffic Association), which had been formed under an agreement that seemed carefully drawn to avoid the statute, was legally dissolved, many people thought that the court swung over to the other extreme when it used this language:

> By the simple use of the term, contract in restraint of trade, all contracts of that nature, whether valid at common law or otherwise, would be included, and not alone that kind of contract which was invalid or unenforcible as being in restraint of trade.

The public awaited anxiously some further expression from the court. Certainly, it was argued, the court could not mean all that could be implied from that sentence standing alone and by itself. If Jones sold his business to Smith and retired, the contract of sale, it would seem, would be invalid. Moreover, the business man insisted, there is a distinction between restraint of competition and restraint of trade. The former is not interdicted; only the latter. And a combination might reduce the extent of competition,

but not its intensity; for if some of the competitors combined, the competition would be between giants and not pygmies.

Finally, in 1911, the Standard Oil Company and the American Tobacco Company were dissolved. This action seemed to indicate that the court had reverted to the opinion it held when the common law was relied upon. The "rule of reason" promulgated in these cases simply means that the court will try to look at the facts of each case as it comes forward. No arbitrary rule—such as the one which states that a combination composed of fifty per cent of the concerns in any industry is a violation of the law—will be set up. But the *effects* of all the acts done will be weighed, and if it is proved that those acts have injured the public they will be condemned and the guilty parties will be punished. Since these decisions were announced, several other important cases have been decided. Others are still pending.

7. *Trust legislation in Canada.*—In Canada there is not the elaborate anti-trust legislation which is to be found in the United States. Frequently the Dominion Government in incorporating companies by letters patent specifically authorizes them to control or amalgamate with other companies similar in nature. Tho the intercorporate control which may result from the exercise of these powers may, and does, actually cause abuses, this leniency indicates the sense of Parliament to be that in itself intercorporate control is not against public policy. It assumes the bona

fides of the applicants. If, however, the power is abused, as for example, if it is found that companies had used the right to amalgamate for the express purpose of accomplishing one or more of the things prohibited by the Criminal Code, the merger or amalgamation could probably be invalidated. What the offenses are will appear from Section 498 of the Criminal Code which provides a penalty of not more than $10,000 and not less than $1,000 where a company conspires, combines, agrees or arranges with any other person, or with any railway, steamship or transportation company,—

(a) To unduly limit the facilities for transporting, producing, manufacturing, supplying, storing or dealing in any article or commodity which may be a subject of trade or commerce; or

(b) To restrain or injure trade or commerce in relation to any such article or commodity; or

(c) To unduly prevent, limit, or lessen the manufacture or production of any such article or commodity, or to unreasonably enhance the price thereof; or

(d) To unduly prevent or lessen competition in the production, manufacture, purchase, barter, sale, transportation or supply of any such article or commodity, or in the price of insurance upon person or property.

In 1910, also, the Dominion Parliament passed a statute known as an "Act to provide for the investigation of Combines, Monopolies, Trusts and Mergers." An investigation is initiated upon an application of a

number of persons to a judge, who may issue an order that an investigation be held into the alleged combine. The order being granted, it is transmitted to the Minister of Labor who thereupon appoints an investigating board of three members. The act provides forfeitures and penalties in case the report of the board establishes that illegal conditions exist.

8. *Federal Trade Commission Law.*—In the political campaign of 1912 the trust evils were much discussed, and the general opinion was that the problem had not yet been solved. More legislation was promised, and the promises were fulfilled in the Federal Trade Law and the Clayton Law. The former, besides creating the Federal Trade Commission, described below, prohibited "unfair methods of competition." But the law does not define unfair methods of competition. It was felt, however, that monopolies were frequently created not by buying up competitors or combining with them, but by ruining them; this inhibition was therefore directed at one of the causes of monopoly.

9. *Clayton Law.*—The Clayton Law specifically mentions and prohibits four practices, and prescribes penalties for infringement.

(a) Discrimination in price, as between different purchasers, is prohibited "where the effect of such discrimination may be to substantially lessen competition or to tend to create a monopoly in any line of commerce." Allowance is made for differences in grade

or quality, location of markets and for "discrimination in price in the same or different communities made in good faith to meet competition." Moreover, the law does not prohibit merchants from "selecting their own customers in bona fide transactions and not in restraint of trade."

(b) Tying or conditional contracts are prohibited. The section that sets this limitation is intended to prevent manufacturers from resorting to a practice that has been used to extend the monopoly of a patent for an invention beyond the manufacture and use of the patented article. Thus, machinery, the possession of which is protected by patents of great importance, has been leased or sold under contracts which provided that they should be used only in connection with other goods of manufacture by the maker of the patented machine. These tying contracts are now under the ban of the law.

(c) The law specifically prohibits corporate stockholding when its effect "may be to substantially lessen competition." Certain express exceptions are made. For example, the holding of stock for investment, the forming of subsidiaries to carry on branches or extensions of a business, and the owning of branch railroads are specifically permitted. It is generally felt, in view of the decisions in the Northern Securities case that this provision adds nothing to the Sherman Law.

(d) Interlocking directorates are prohibited. This restriction applies in the case of: (1) directors

of two or more corporations engaged in interstate commerce and having capital, surplus and undivided profits amounting to more than $1,000,000; (2) directors, officers and employes of national banks with deposits, capital, surplus and undivided profits of more than $5,000,000; the restriction applies also to those holding these positions in national banks in cities of more than 200,000 inhabitants. This provision does not apply to railroads. One section of the law, however, prohibits railroads from buying more than $50,000 a year worth of goods from supply houses with which they have interlocking directorates, unless the purchases be made as the result of a successful bidding that was open to competitors. The corporations were given two years within which to comply with the provisions of the law in regard to interlocking directorates.

10. *Penalties and suits to prevent violation of anti-trust laws.*—Violation of the United States trust laws is considered a crime, for the punishment of which the court generally specifies definite penalties. The persons who are injured usually bring private suit. If this is done, whatever damages are proved are usually multiplied by three, to ascertain the amount of the judgment. Injunctions to prevent the continuance of the prohibited acts may be sought. Section 14 of the Clayton Law is thought to be sufficiently terrifying to halt the most daring. It provides that whenever a corporation violates any of the penal provisions of any of the anti-trust laws, the individual directors,

officers or agents who have authorized, ordered or done any of the acts constituting such violation shall be held responsible. The punishment upon conviction shall be a fine not exceeding $5,000, or imprisonment not exceeding one year, or both.

11. *Federal Trade Commission.*—At least some mention of the Federal Trade Commission is essential to a complete treatment of the subject under discussion. The Commission, which consists of five members appointed by the President, has power to require annual and special reports from all corporations, except banks and railroads, engaged in interstate or foreign commerce. It may also prescribe what these reports shall contain. But the Commission may not prescribe uniform systems of accounts, a power which the Interstate Commerce Commission possesses for the railroads. The difficulties in the way of formulating such accounting systems for different lines of business were readily appreciated by Congress when the act establishing the Commission was drafted. However, any person who makes a false entry in an account of any corporation subjected to the Commission's jurisdiction is guilty of a misdemeanor. The Commission has the right to inspect all books and accounts; their inspection largely precludes the possibility of false entries being made the means of forestalling legal action. The Commission may publish any of the information that it collects, except "trade secrets" and the names of customers.

12. *Power of Federal Trade Commission to en-*

*force anti-trust laws.*—The Federal Trade Commission is given certain powers in regard to the enforcement of the anti-trust laws. It may institute hearings, and if it finds that the defendant has carried on unfair competition, made discrimination in regard to prices, or violated the law concerning corporate stockholders or interlocking directorates, it may issue an order to prevent further violation. If the findings of the Commission are supported by testimony, they are final as to the facts.

If the Commission's order is not obeyed the case goes directly to the Circuit Court of Appeals, whose jurisdiction over the orders of the Commission is exclusive, and whose judgment and decree are final. The Commission has the authority to recommend to the court a proper decree for the dissolution of a combination found to be violating the trust laws. It also has the right to investigate the manner in which the decree as dissolution against the defendant in a monopoly case is carried out. It is to be hoped that this power will be sufficient to insure the observance of the anti-trust statutes in spirit as well as in form.

13. *The Webb-Pomerene Act.*—One of the most insistent objections to the American law against combinations has been directed against the unfairness of the situation that American exporters find themselves in when competing with foreign combinations in foreign markets. To remedy this evil Congress has passed the Webb-Pomerene Act permitting American competitors to organize for foreign trade. Under

this act foreign selling agencies may be formed or a corporation may be organized to handle in foreign countries the products of American competitors. It would seem that almost any arrangement is permissible so long as it does not affect trade within the United States and so long as it does not unfairly compete with some American exporter who has not joined in the arrangement.

## REVIEW

Enumerate all the grounds on which the steel-rail pool described in Chapter XV would be considered illegal today.

Explain carefully the difference between the common law of monopolies and the Sherman Anti-Trust Law.

Suppose your competitors consolidated and forced down prices in the part of the country where you are doing business, but raised prices in other parts of the country. What redress would you have and how could you proceed to protect yourself?

What practices are prohibited by the Federal Trade Commission?

# INDEX


**Addyston Pipe Pool,**
Description of, 239; Haney, on, 239–40
**Agreements,**
Partnership, 40; Sample of, 41; Limited partnership, 52; Form of, for syndicates, 60–62
**Alien Enemy,**
Rights of, 24; Legal position of, as defined by President Wilson, 25
**Aliens,**
Rights of, 24; Classes of, 24
**Amalgamation,** English equivalent of, 249
**American Tobacco Company Amalgamation,** 253–56
Dissolution of, 294
**Anti-Trust Statutes,** 291
Sherman Anti-Trust Act, 290, 292; Federal anti-trust laws, 292; Penalties and suits to prevent violation of, 298
**Assets,**
Intercorporate relations thru sale of, 258; Right to buy and sell, 259; Right of directors to sell, 259; Stockholders' rights to authorize sale, 260; Effect of sale, 260; Sales as a means of concentrating parts of an industry, 261; Consideration paid for, 262; Advantages and disadvantages of sale, 262
**Associations, Trade,**
*See* Trade Associations
**Auditor,** Duties of, 218
**Authorized Stock,** 185

**Baldwin Locomotive Works,** as example of Partnership, 44
**Banking,**
Corporate form of banks, 17; Manhattan Company of New York, 112
**Bondholders**
Receivers manage business in interest of, 151; Right to subscribe to stock, 190
**Bonds,**
Distribution of, in syndicate transactions, 69; Convertible into stock, 179; Right of stockholders to subscribe for, 179
**Books of a Corporation,**
Inspection of, 201; Classes of, 201
**Burr, Aaron,** Incorporation of the Manhattan Company by, 112
**Business,**
Right to enter, 23; State restrictions upon, 26
**Business Organization, Purposes and Forms of,**
Purposes of, 1; Risk of ownership, 2; Apportioning control, 3; Different forms of, 3; Facility of formation, 8; Permanence of association, 8; Capital for large-scale organization, 9; Flexibility of organization, 9; Evolution of business organization, 10; Rise and development of corporations, 10; Struggle of corporation for supremacy, 11; Early corporate abuses, 12; Disadvantages of the corporation, 13; Advantages of the corporation, 14; Place of the corporation in modern business, 15; Transportation, 15; Utilities, 15; Insurance, 16; Banking, 17; Manufactures, 18; Why individual and partnership organization persists in manufacturing, 20; Incorporation in other fields, 21; Individual and, 22; Of partnership, 44
*See* Intercorporate Relations
**Business Trusts,** 6
*See* Trusts, Business
**Business Units, Corporations as,**
*See* Corporations as Business Units
**By-Laws of Corporations,**
Provisions of, 134; May be adopted or amended by a vote of the stockholders, 135

**California Petroleum Company,** 167
**Canada,**
Position of alien enemy in, 25; Powers of corporations in, 115; Incidental powers of corporations in, 117; Foreign corporations in, 120; Corporate charter in, 124; Incorporating in, 131–136; Dissolution of corporations in, 147, 151; Dominion Winding-Up Act, 147; Transfer of stock in, 156; Dividends in, 161; Victor E. Mitchell, K.C., 161; Meetings of stockholders in, 188; Inspection of corporate books, 202; Liabilities of officers in, 223; Companies, 274; Trust legislation in, 294
**Car Trusts,** 83
**Certificate of Incorporation,**
General nature of, 128; Must contain nine clauses, 128; May be amended by a two-thirds vote of the stockholders, 129
**Certificates of Stock,** 155
Specimen of, 157; Lost, 158; As evidence of stockholders' rights, 158
**Chairman of Board,** Powers of, 214
**Charter, Corporate,**
*See* Corporate Charter
**Choice of State for Incorporation,**
Legal restrictions, 136; Practical considerations, 139–41; George W. Wickersham on, 139–41; Favored states, 141
**Clark, Victor S.,** 12
**Clayton Law,**
Prohibitions of, 222; Anti-trust legislation, 296
**Combinations,**
Purposes of, 7; Classes of, 226; Forms of, 227; National Cordage Company, 227; Advantage of, 279–280; Illegal, 288–301; History of the common law of monopolies, 288; Common law of monopolies, 289; Violation of common law of corporations, 289; Anti-Trust statutes, 291; Sherman Anti-Trust Act and amendments, 292; Meaning of Federal anti-trust laws, 292; Trust regulations in Canada, 294; Federal Trade Commission Law, 296; Clayton law, 296; Penalties and suits to prevent violation of anti-trust laws, 298; Federal Trade Commission, 299; Power of Federal Trade Commission to enforce anti-trust laws, 299; Webb-Pomerene Bill, 300
**Committee, Finance,** 212
Vacancies, how filled, 212; Action to be reported to Board, 213; Rules of procedure, 213; Membership, 213; Powers and duties, 213; Powers of chairman, 214
**Common Law,**
Monopolies, 288; Violation of, by corporations, 289
**Community of Interest,**
Meaning of, 242; General Electric Company, 243; Types of, 244
**Companies, Incorporation of,**
Corporate charter, 124; Special requirements for, 126; Certificate of, 128; Organizing a corporation, 129; Incorporating in Canada, 131; By-laws, 134; Where to incorporate, 135; Questions to be considered before choosing a state, 136 Deciding upon the state, 136; Deciding upon the state in which to incorporate, 141
**Concentration,** Causes of, 226
**"Consolidated,"** meaning of, 154
**Consolidation, of Corporations,** 249
Meaning of term, 249; Statutory authority necessary, 250; Nature of, 251; Method of, 251; Effect on old corporations, 252; Effect on status of creditors, 252; Amalgamation of American Tobacco Company, 253; Advantages of, 256; New York Central consolidated with Lake Shore and Michigan Southern, 256; Disadvantages of, 257
**Contracts,**
By aliens, 24; *Ultra vires,* 118; By directors of corporation, 220; Powers of corporation officers, 220
**Control,**
Apportioning, 3; Complementary to risk, 3; Element of ownership, 9; Of stockholders, 165; Conversion as a method of, in corporations, 179; Thru redemption, 181
**Controller,** of Corporation, 218
**Control, Under Sole Proprietorship,**
Simplicity of, 27; Advantages of, 27–32; Right to make contracts, 27; State and, 26, 28; Flexibility of movement, 28; Secrecy, 29;

**Control—continued**
Survival of the fittest in, 30; Disadvantages of, 33–35; Limited duration, 32; Individual credit is limited, 33
**Conversion,** as a method of control, 179
**Cooperative Associations,** 6
**Corporate Charter,** 124–126
In early times, 124; What Congress may grant, 124; Dominion Parliament, 124; By special legislative acts, 125; Massachusetts, 125; New York, 126; General acts, 126
**Corporate Management,** theory of, 208
**Corporate Powers,**
In general, 110; Implied powers, 110; express powers, 112; Incidental powers, 117
**Corporations,**
Dominant form of organization in America, 6; How superior to other forms, 9; Rise and development of corporations, 10; History of, 10; Struggle for supremacy, 11; Early corporate abuses, 12; Victor S. Clark, 12; Disadvantages of, 13; Advantages of, 14; Place in modern business of, 15; Railroads as, 15; Utilities as, 15; Insurance business as a, 16; Banks as, 17; Manufacturers as, 18; In other fields, 21; History of, 94; Guilds, compared to, 94; Rise of the regulated company, 95; In American colonies, before the Revolution, 96; In America, after the Revolution, 96; Number of, in Massachusetts in 1915, 98; Turning a going business into, 99; Organizing, 129; Dissolution of, 144–52
*See* Corporations as Business Units; Corporations, General Aspects of
**Corporations, as Business Units,**
History, 94; In modern business, 97; Corporations assemble large capital, 98; Turning a going business into a corporation, 99; Government business corporations, 102; Public, quasi public and private corporations, 104; Investors' classification of, 105
**Corporations, Dissolution of,**
Duration, 144; Dissolution, 144; Voluntary, 145; Involuntary, 146; Effect of death of members and of bankruptcy of a corporation, 148; Corporate receivers, 149; Qualifications of a receiver, 150; Dissolution in Canada, 151; Dividends on, 163
**Corporations, General Aspects of,**
Nature of, 107; Corporate powers, 110; Implied powers, 110; Express powers of corporations, 112; Incidental powers, 117; *Ultra vires* contracts, 118; Corporations are persons but not citizens, 119; Classification of corporations, 120; Foreign corporations, 120; General and special franchises, 121; *De jure* and *de facto* corporations, 122; Organizing, 129
*See* Companies, Incorporation of
**Creditors,**
Effect of consolidation on, 252
**Cumulative Votes,** 173
Strategy of, 174

**Dartmouth College,** Decision on, 108
**Deal,**
Putting thru, by syndicates, 66; Famous deals, 73–76; Fisk-Gould-Drew syndicate, 73; Hill-Morgan syndicate, 74
**Deed of Trust,** 82
**Dewing, A. S.,** Personal Element in Business, 31, 258 n
**Directors,**
As trustees in dissolution, 145; Discretion of, 158; Right to declare dividends, 158; Theory of corporate management, 208; Number and qualifications of, 209; Meetings and quorum, 210; Powers of, 210, 219; Committees, 212; Power to make contracts with themselves, 220; By-laws of the United States Steel Corporation, 221; Liability in Canada, 222–224; Compensation of, 224; Right to sell corporate assets, 259
**Dissolution of Corporations**
*See* Corporations, Dissolution of
**Dissolution of Partnership,** 43
**Dividends,**
Meaning of, 158; Who has the right to declare, 158; Sources of, 159; Who is entitled to, 160; Ownership of dividends on securities bought and sold on the New York Stock Exchange, 161; Dividends on dissolution, 163

**Domett, Mr., on Bank of New York,** 112
**Dominion Railway Act,**
Restriction on directors, 222
**Dominion Winding-Up Act,** 147, 223
**Dormant Partner,** 47

**Edison, Thomas A.,** Beginning of career, 30
**England,**
Corporation shares in, 153; "Consolidated" stock in, 154; Corporate meetings in, 200

**Federal Trade Commission,**
Law, 296; Membership of, 299; Power to enforce anti-trust laws, 300
**Financial Companies,** 282
**Fisk-Gould-Drew Syndicate,** 73
**Foreign Corporations,** 120
**Forfeiture of Stock,** 185
**Forms and Purposes of Business Organization,** 1
**Franchises, of Corporations,**
General, 121; Special, 121
**Full-Paid and Part-Paid Stock,** 187

**Gary, Judge,** 281
**General Counsel, of Corporation,** 218
**General Electric Company,** 243
**General Partnerships,**
*See* Partnerships, General
**Government Business Corporations,** 102
**Guilds,**
Position of, in medieval times, 94

**Haney, L. H.,** on Addyston Pipe Pool, 239
**Harriman and Kuhn-Loeb Syndicate,** 74
**Holding Companies,**
Rise of, 271; Magnitude of interest involved in, 272; Classification of, 273; Right of a company to hold stock in other companies, 273; Ownership of majority of stock not necessary for control, 275; Surrender of control of subsidiaries to parent company, 278; Advantages of combining, 279; Advantages of, 280; Financial companies, 282; Management Companies, 284; Complexity of intercorporate relations, 286

**Incorporation of Companies**
*See* Companies, Incorporation of
**Individual and Business Organization,** 22
**Industrial Corporations,** 105
**Industry,** Control, thru special practices, 245
**Insurance Companies,**
Corporate form of, 16
**Intercorporate Relations,**
Causes of concentration, 226; Classes of combination, 226; Various forms of combination illustrated in the history of one concern, 227; Trade associations, 227; Importance, advantages and disadvantages of trade associations, 229; Example of a national trade association, 229; Example of local retailers' association, 234; Successful and unsuccessful undertakings of local association, 235; Pools, 238; Steel pools, 238; Addyston pipe pool, 239; Advantages of pools, 240; Disadvantages of pools, 240; Typical legal trust, 241; Community of interest, 242; Types of community of interest, 244; Control of industry thru special practices, 245; Thru sale of assets, 258; By lease, 263; Complexity of, 286
**Investment Bankers' Association,** 62
**Investor,**
Classication of corporation by, 105
**Issued Stock,** 186

**Johnson, Alba B.,** 44
**Joint Account,** Meaning and use of term, 57
**Joint Adventure,** Meaning and use of term, 57–58
**Joint Stock Company,** 4–5

**Keene, James R.,** Pools of, 75

**Law and Business Organization,**
State restrictions upon business, 26; Legal nature of syndicates, 58; Legal nature of syndicates, not well defined, 62; Legal nature of trusts, 79–81; Court decisions on nature of corporations, 107; General and special franchises with the state, 121; *De jure* and

**Law and Business**—Continued
*de facto* corporations, 122; Corporate charter and, 124–126; Special requirements for incorporation, 126–135; Choosing a state in which to incorporate, 136–42; Liabilities of stockholders, 182; Meeting of stockholders, 188; Inspection of books, 202; Consolidations and, 250
**Leased Premises,** Ownership of improvements on, 265
**Leases of Corporations,** 249–70
Intercorporate relations formed by, 263; Form, 263; Consideration for, 264; Ownership of improvement on leased property, 265; As a means of manipulation, 266; Effect of, 268; Advantages of, 269; Disadvantage of, 269
**Legal Trust,**
Standard Oil as example of, 241
**Liabilities,**
Of syndicate members, 69; Of trustees, 80; Of stockholders, 182
**Limited Partnerships,**
*See* Partnerships, Limited

**Management Companies,** 284
**Manhattan Company of New York,** 112
**Manipulations,**
By means of leases, 266; Other possibilities of, 267
**Manufacturing,**
Corporate forms in, 18; Why individual and partnership organization persists in, 20
**Massachusetts Trusts,** 84
**Meetings of Stockholders,**
*See* Stockholders, Meetings of
**Mining Corporations,** 105
**Minority Stockholders,** 204
Rights of, 205
**Minutes of Stockholders' Meetings,** 192
Form of, 192; Of New York, New Haven and Hartford Railroad, 192; Analysis of, 197
**Mitchell, Victor E.,** 161
**Monopolies, Common Law,** History of, 288
**Mortmain,** Statute of, 79

**National Commercial Gas Association,**
Factors responsible for formation, 230; History, 229–34; Committees of, 232
**National Cordage Company,** 227, 267
**New York Central Consolidated with Lake Shore and Michigan Southern,** 256
**New York, New Haven and Hartford Railroad Company,** Minutes of, 192
**New York Stock Exchange,**
Dividends on securities bought and sold on, 161; Rules of, 162
**Nominal Partner,** 48

**Officers of Corporation,** 208–25
How chosen, 214; Chairman of the board and president, 214; Vice-presidents, 215; Treasurer, 216; Secretary, 217; General counsel, 218; Controller, 218; Auditor, 218; General powers of, 219; Vacancies of removals, 219; Registrars and transfer agents, 219; Organization charts, 220; Power to make contracts, 220; Liabilities of, 223; Compensation of, 224
**Organization, Business, Purposes and Forms of**
*See* Business Organizations, Purposes and Forms of
**Organization, Purposes of,** 1–2
**Outstanding Stock,** 186
**Ownership,**
Risk of, 2; Three Elements of, 9; Control as third incident of, 165

**Panama Railroad,** Use of, 103
**Parent Companies,** Surrender of control of subsidiaries to, 278
**Partners,**
Kinds of, 47–49; Silent partner, 47; Dormant partner, 47; Secret partner, 47; Nominal partner, 48; Rights and liabilities of, 54
**Partnership Agreements,**
Nature of, 40; Sample of, 41; Form of limited partnership agreements, 52
**Partnerships,**
Easily formed, 4, 8; Easily destroyed, 9
**Partnerships, General,**
History of partnership, 36; Nature of, 36; How formed, 37; Elements of, 37; Incidents of, 38; Right of partner to compensation and share in the profits, 39; Partnership agreements, 40; A sample agreement, 41; Dissolu-

**Partnerships, General**—continued
tion of, 43; Example of partnership organization, 44; Some disadvantages of, 46; Kinds of partners, 47; Distinguished from the syndicate, 59
**Partnerships, Limited,**
History, 50; Essential features of, 50; Method of forming and terminating, 51; Form of agreement of, 52; Rights and liabilities of members, 54; Advantages of, 54; Disadvantages of, 55; Conclusion, 55
**Police Power of State,** 26
**Pools,**
Description of, 238; Steel, 238; Addyston pipe, 239; Advantages of, 240; Disadvantages of, 240
**President, of Corporation,** Powers of, 214
**Private Corporations,** 104
**Profits,**
Right of partners to share in, 39
**Proprietorship, Sole,**
The individual and business organization, 22; Who can enter business, 23; Rights of aliens, 24; State restrictions upon business, 26; Simplicity of control, 27; Flexibility of movement, 28; Secrecy, 29; Stimulus to individuals, 29; Survival of the fittest, 30; Limited duration, 32; Individual credit is limited, 33; Where sole proprietorship is most successful, 34; Future of, 34
**Proxies,**
Number of votes for, 171; Use of, 174; Form of, 175
**Public Corporations,** 104
**Public Utilities,**
As corporations, 16

**Quasi-Public Corporations,** 104
Special franchises of, 121
**Quorum,**
By-laws, 134; Stockholders' meeting, 198

**Railroads,**
Corporate form of, 15; Car trusts, 83; Voting trusts and, 91
**Receivers,**
Corporate, 149; Qualifications of, 150
**Registrars,** Duties of, 219
**Restrictions,**
On business, 26–27
**Retail Grocers' Association, Activities of,** 234–238
**Risk,**
Of ownership, 2; Element of, in ownership, 9

**Sales of Corporations,** 249–70
**Sears, John H.,** 88
**Secretary,** of Corporation, 217
**Secret Partner,** 47
**Share of Stock,**
Meaning of in United States, 153; In England, 153
**Sherman Anti-Trust Act,** 290, 292
**Silent Partners,** 47
**Sole Proprietorship,**
*See* Proprietorship, Sole
**Standard Oil Company,** as type of legal trust, 241, 294
**State,** Choice of, for Incorporation.
*See* Choice of State for Incorporation
**Statute of Mortmain,** 79
**Steel Pools,** 238
**Stock and Dividends,**
Stock, 153; English nomenclature, 153; Classes of stock, 154; Certificates of stock, 155; Transfers of stock, 155; Lost certificates, 158; Stock certificates as evidence of stockholders' rights, 158; Dividends, 158; Who has the right to declare dividends?, 158; Sources of dividends, 159; Who is entitled to dividends, 160; Ownership of dividends on securities bought and sold on the New York Stock Exchange, 161; Dividends on dissolution, 163
**Stockholders,**
Rights of, 165; Who has the right to vote, 166; Depriving certain classes of the right to vote, 167; Special rights to vote on certain questions, 168; Referring matters to, 169; Number of votes to each stockholder, 170; Right to vote, between successive and joint owners, 171; Method of counting votes, 173; Cumulative voting, 173; Strategy of cumulative voting, 174; Proxies, 174; Right to maintain proportion of control, 176; Form of negotiable rights, 177; Right of bondhold-

**Stockholders—continued**
ers to subscribe to stock, 178; Right of stockholders to subscribe to bonds and notes, 179; Conversion as a method of control, 179; Control thru redemption, 181; Liabilities of, 182; Forfeiture of stock, 185; Kinds of stock, 185; Authorized stock, 185; Issued stock, 186; Unissued stock, 186; Outstanding stock, 186; Treasury stock, 186; Full-paid and part-paid stock, 187; Rights to authorize sale of assets, 260

**Stockholders, Meetings of,**
Meetings, 188; Place of, 188; Notice of, 190; Transactions of business, 191; Minutes, 192; Form of minutes, 192; Analysis of minutes, 197; Quorum at stockholders' meetings, 198; Conduct of meetings, 199; British corporate meetings, 200; Inspection of corporate books, 201; Minorities, 204; Rights of minorities, 205

**Syndicates,**
Purpose of, 7; Defined, 57; History of, 58; Legal nature of, 58; Form of syndicate agreement, 60; Administration of, 61; Members cannot bind the syndicates, 62; Rules governing administration of, 62; Liabilities of syndicate members, 63; Forming, 64; Putting thru a deal, 66; Usual methods of dividing liability, 69; Method of settling a syndicate, 70; Rights of syndicate members, 72; Famous deals, 73; Organizers of, 74

**Taussig, Dr. F. W.,** 29
**Trade Associations,**
Types of, 227; Illegal, 227; Legal, 228; Example of national, 229; National Commercial Gas Association, 229–34
**Transfer Agents,** Duties of, 219
**Transfer of Stock,** 155
**Transportation,**
Railroads as corporations, 15
**Treasurer, of Corporation,** 216
**Treasury Stock,** 186
**Trust Certificate,** Example of, 86
**Trustee,**
Duties of, 78
**Trusts, Business,**
Popular meaning of, 77; Original trusts, 78; History of, 78; Purposes of, 79; Legal nature of, 79; Liabilities of trustees, 80; Liabilities of beneficiaries, 81; Deed of trust, 82; Car trusts, 83; Massachusetts trusts, 84; Duration of, 85; Form of certificate of beneficial interest in, 85; Kinds of, 87; Voting trusts, 89; Trusts within trusts, 90; Voting trusts and the railroads, 91.

**Ultra Vires Contracts,** 118
**Unissued Stock,** 186
**United States Shipbuilding Company,** 279
**United States Steel Corporation,**
Directors of, 209; Committees of directors, 221

**Vice-Presidents, of Corporations,** 215
**Vote,**
Who has the right to, 166; Stockholders deprived of right to, 167; Special rights to vote on special questions, 168; Number of, 170; Successive and joint owners, right to, 171; Method of counting, 173; Cumulative, 173–174; Proxies, 174
**Voting, Strategy of cumulative,** 174
**Voting Trusts,**
Cushing's "Voting Trusts," 88; Device to place voting power, 89; Trusts within trusts, 90; Railroads and, 91

**Webb-Pomerene Bill,** 300
**Westinghouse Electric and Manufacturing Company,** 190
**White, J. G., and Company,** 285
**Wickersham, George W.,** 139–41
**Winding-Up Act, Dominion,** 147, 223

THE·PLIMPTON·PRESS
NORWOOD·MASS·U·S·A

DATE DUE

| | | | |
|---|---|---|---|
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| GAYLORD | | | PRINTED IN U.S.A |

HF
5351
.M76
1919
v.3

000344

Gerstenberg, C. W.
Organization and
control.

000344

HF
5351
.M76
1919
v.3
W

Gerstenberg, C. W.
Organization and
control.

HF
5351
.M76
1919
v.3
W

000344

Gerstenberg, C. W.

Organization and control.

DR. NORMAN A. WIGGINS